

JPRS-CAR-93-091
29 December 1993



JPRS Report

China

China

JPRS-CAR-93-091

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Xu Jiatun's Memoirs Discuss Unions, Basic Law

94CM0050A Hong Kong LIEN HO PAO in Chinese
13, 14, 15 Jun 93

[Installments No 40, 41, and 42 of the serialized memoirs of Xu Jiatun (6079 1367 1470): "Xu Jiatun's Hong Kong Memoirs"]

[13 Jun 93 p 2]

[Text] **Determining the New Direction of the Labor Unions: The Leftist Labor Union Lacks a 'Liu Qianshi'; Zou Feng Resolves Taxi Strike**

For a long time, the 'leftist' labor unions, with "class struggle as the guiding principle," have seen their main duty as that of responding to and supporting movements within China. By neglecting to strive for the welfare of Hong Kong workers, they have seriously distanced themselves from the reality of Hong Kong. The "centrist" labor unions have taken advantage of this gap and showed off their strengths. I met an older worker in the New Territories who told me unhappily "We are always promoting movements but we forget about working for benefits for our fellow workers. Liu Qianshi goes everywhere working for benefits for workers. Wherever there is a wage dispute, there is Liu Qianshi. Now Liu Qianshi is famous in all of Hong Kong but no one has heard of our union leaders." At that time, I had only been in Hong Kong a few days and had not even heard of a person named Liu Qianshi.

The "Resist British Repression" activity was conducted under the political influence of the "left." The "leftist" unions which led this activity suffered great damage to their political image in Hong Kong society, to the extent of being seen as "thugs." The British Government arrested several thousand people, the majority of whom were workers in the labor union. Even after being released, many of these were fired by the capitalists. After that, the "leftist" unions were in a state of paralysis. Communist Party members were exposed, and the British were well informed on the party organization. In addition, the union leaders were old and projected unfavorable images in society, some to the extent of being labelled "leftists." They could not handle the situation. Furthermore, most of the union members were older blue collar workers with little education. Therefore, some very important tasks I faced after arriving in Hong Kong were to reorganize the "leftist" unions, clarify the correct direction of the unions, and solve the problem of hesitant, depressed union organizers.

Many union organizers and workers, with their simple class feeling, did not understand the error of the "Resist British Repression" activity. They wondered what could be the error of opposing England? Should one not oppose British imperialism and colonialism? They also did not understand the central government's new policy on Hong Kong, with the plan to "retake but not liberate" Hong Kong and allow capitalism to be retained for so many years. To them, "let Hong Kong people rule Hong

Kong" really meant letting the capitalists rule Hong Kong. They questioned whether this was not a violation of Marx's call for the working class to lead all. Why not let the working class lead?

To address these problems, we repeatedly explained that "Resist British Repression" was a means for the Gang of Four to take advantage of the patriotism of Hong Kong workers to alter the central government's correct approach to Hong Kong of "long-term planning, ample utilization" and to use violence to take Hong Kong back ahead of schedule. This was an error committed by the Gang of Four controlled central government, not by the Hong Kong working class. The Hong Kong workers, however, should extract some lessons from this.

On the question of "taking back but not liberating" Hong Kong, we hoped to persuade them to a "unified understanding" by using the principle of unifying short-term and long-term advantages and the maximum and minimum goals of the working class. The charter of the Chinese Communist Party [CPC] points out that the party has a maximum goal and a minimum goal. The maximum goal is to implement communism. The minimum goal is to temporarily implement socialism. To relate this to the practical struggle in Hong Kong, "one country, two systems" is the party's minimum goal in Hong Kong and is the goal in the current struggle. We have not abandoned the maximum goal of implementing communism in Hong Kong in the future, but that is a long-term goal. The future method of implementation will be determined through exploration of current and future practical experience. We defined the new direction of the unions, which was that the unions should work for the return of Hong Kong, for the implementation of "one country, two systems," and to maintain the stability and prosperity of Hong Kong. Currently, the unions should strive for benefits for the workers. The unions should be concerned with Hong Kong society and with their own benefits. This is their main duty. To coordinate with the mainland, the unions should first consider the situation in Hong Kong and not use the same methods as in the mainland. In striving for benefits for the workers, they must follow the main approach of "one country, two systems." In conflicts and struggles with the capitalists, they should adopt the policy of benefit to both labor and capital and the method of consultations between labor and capital. They should not jump to strike as a struggle method and consider other appropriate methods only when necessary. In other words, consultation itself should be seen as a struggle method.

During the taxi driver strike of 1985, there was a demonstration on Nathan Road in Kowloon. Representatives of the strikers came to XINHUA to present a petition. We sent Zou Feng to receive them and tell them that this issue fell under the purview of the Hong Kong government and should be resolved by that government. Public opinion was very favorable, noting that XINHUA had not taken advantage of the strike to interfere in the matters of the Hong Kong government. We agreed to

send Zou Feng out because he had been a director of "Resist British Repression" and was seen by some Hong Kong people as a "leftist" who made a bad impression. We wanted to use this opportunity to change his image and that of the "leftist" labor unions. Later, the unions used the approach of "resolve through consultation for benefit to both labor and capital," and through consultation with the capitalists, quickly reached a settlement and smoothly ended the strike. This evoked a favorable response in Hong Kong society, especially in the commercial and industrial circles. At the time, the "centrist" unions also participated in the strike, taking over leadership of the strike. They put forth slogans and great demands but were not accepted by the workers.

The facts show that after the "leftist" unions defined a new work approach in keeping with the Hong Kong reality, they were accepted by the working classes of Hong Kong and by Hong Kong society.

With the new form and new approach in place, we conducted a rectification of the "leftists," relying upon the efforts of the unions themselves to develop new leaders to replace the old ones. The thinking of the older generation was dominated by "left" consciousness. Their image in society was not favorable, and they had difficulty changing. Thus, we needed to cultivate a new generation of young, knowledgeable, open-minded people. The current leaders in the union were all developed in this way. I directed Zheng Hua, who was assigned to oversee the unions, to allow the union leaders to have their own style and language and to use means of expression different from those used in the mainland or by the XINHUA. Even when they differed from us, they were not to be chastised. They were to be allowed to do their work without restraint to avoid distancing themselves from the masses. We also sent Tan Yaozong to the Great Britain to study. In recent years, he has performed well in the Legislative Council. He can represent the workers but without giving people a "left" impression. Society is able to accept him well and his name is well-known. His relationship with rightist union and Legislative Council member Peng Zhenhai is also quite good. There is also Chen Wanxian, who earned over 40,000 votes in the direct elections of 1991 and was only 1,000 votes short of being elected. She also has a good image in society. These are all new leaders cultivated by the unions.

Another key task was to reorganize the structure of the unions. Union members had to re-register. The emphasis was on recruiting younger, better educated, white collar class members. New unions were established to attract these people, and there were activities to project a new image to broaden the influence of the unions. After the rectification of the unions began in 1984, each year the members recruited under the "leftist" unions decreased by about 10,000 people (due to retirement at old age or death) and about 10,000 new members were attracted to the unions. "Gains and losses" are equivalent and membership is steady at about 170,000 people.

To further develop the unions, we developed other types of mass organizations through the unions. After the XINHUA branch established three district offices and branch working committees, the unions began implementing two types of leadership. The grass roots level unions were led both by the upper levels of the unions and by the branch working committees. The upper levels of the unions were responsible for union business, and the branch working committees were responsible for party work. At first, they were not used to this and there was much resistance, but the goal of the two types of leadership was that, under the unified planning of the branch working committees, in addition to their own duties, the unions could also assist with some other tasks. For example, they could work with the residents of the housing estates. After the direct elections of 1992, we read in the newspapers that the unions had established district branch offices. I believe that they realized the importance of the local level. [Installment No. 40]

[14 Jun 93 p 3]

[Text] **Striving for Cooperation, Unity Among Three Factions: Developing Centrist Unions, Striving for Right-Leaning Centrists; Tusi Hua Once Requested Communist Party Membership** The working classes of Hong Kong have three special characteristics: One is that they are splintered; two, white collar workers are constantly increasing; three, while mobility and change are great, benefits are low.

Most workers have not joined the unions. Union membership totals less than 250,000, which is only 30 percent of Hong Kong's over 800,000 production workers and less than 10 percent of Hong Kong's 2.8 million working class people.

In this situation, the unions were divided into three factions: Left, center, and right. The "leftist" unions were led by the Chinese Communist Party, the "rightist" unions were controlled by Taiwan's Kuomintang, and the main leader of the "centrist" unions was Liu Qianshi of the Christian Industrial Committee.

Of the three types of unions, the "leftist" had the greatest strength. At the time, they claimed 200,000 members, of whom 170,000 were registered and paid dues. The "rightist" unions had over 30,000 members, and the "centrist" unions had 20,000 to 30,000 members.

Because of the delineation of influence between the two major factions, the left and the right, the unions and the working classes in Hong Kong have always been divided into opposing groups with very little interaction.

The approach of the Hong Kong and Macao working committee was to gradually resolve the split among the working classes of Hong Kong. They required the "leftist" unions to perform united front work and to strive for solidarity with the "rightist" and "centrist" unions.

Every year on 1 May, International Labor Day, and on 1 October, Chinese National Day, the "leftist" unions

have held a reception. The unions and XINHUA both invited members of the "rightist" unions to participate. I always attended. In 1985, I took advantage of participating in the union reception to seek out the leaders of the "rightist" and "centrist" unions and conduct an informal discussion. On that day, it was not arranged in advance. Zheng Yaotang of the "leftist" Workers Alliance Union told me that they were all there. On the spur of the moment, I asked to see them and sit and have a talk. I talked about the need for Hong Kong workers to unite and not split into left, right, and center, but work together to implement "one country, two systems" and work for prosperity in Hong Kong. I also answered questions they raised. They appeared quite satisfied. Contact between the "leftist" and "rightist" unions gradually increased. The Hong Kong government organized a labor advisory committee and the Hong Kong British government intended to include representatives of the "rightist" unions as committee members. The "leftist" unions then had two choices, either to boycott or to join this organization. We decided to join and determined that we would cooperate with the "rightist" unions. We jointly chose representatives and created an opportunity for an alliance between the left and right union factions.

Based on the actual situation in Hong Kong, workers' views on the Communist Party were influenced in several ways. The white collar workers in particular already held a very different view, hence they were unlikely to be attracted to join the "leftist" unions. To unite with these people, we had to develop the "centrist" unions. We decided to support the "centrist" union organized by Li Qiming and others of the Hong Kong Kowloon United Labor Association and nominated Li to be vice director of the Information Committee to improve his name recognition.

To strive for the "center" we not only had to recruit workers but also teachers and civil servants. Tusi Hua was formerly a member of a group of young, patriotic teachers who called for a return to China. He once asked to join the Communist Party. After I came to Hong Kong, I met with Tusi Hua once or twice a year. He once told me that after reading the *Selected Works of Chen Yun*, he no longer wanted to join the Communist Party. As a non-party member, it would be easier for him to do his work and he would have a greater degree of individual freedom. I agreed with his approach. I felt that the majority of people in Hong Kong were right-leaning centrists. It was extremely important to strive for the influence of the right-leaning centrists. Much of our work needed to be considered from this angle.

The new working goal of the "leftist" unions was to eliminate divisions and strive for solidarity and cooperation among the three factions of unions. Although they have made great efforts during the last few years, the results have not all been as good as intended. [Installation No. 41] [End of Chapter 5]

[15 Jun 93 p 2]

[Text] Chapter Six: The Controversy Over Future Politics. The Most Important Task of the Transition Period—In Drafting the Basic Law, Deng Xiaoping Raises Three Principles; Troops Will Only Move In If There Are

After the Joint Communique between China and I was formally signed, Hong Kong entered the transition period before returning to China. The most important task of the transition period is to establish the Basic Law for the Hong Kong Special Administrative Region.

Annex 1 of the Joint Communique between China and Britain, "Specific Explanation by the People's Republic of China on the Hong Kong Basic Law Direction and Policy," states that "The National People's Congress of the People's Republic of China shall enact and promulgate the Basic Law of the Hong Kong Special Administrative Region of the People's Republic of China, based on the Constitution of the People's Republic of China, which will stipulate that for 50 years after the establishment of the Hong Kong Special Administrative Region, the socialist system and policies will not be implemented and Hong Kong's existing capitalist system and way of life will not change."

This formal announcement and promise by the Chinese government demonstrated that China intended to use law to regularize national policies to guarantee that the country's basic direction and policies on Hong Kong would be implemented in a legal, stable and long-term fashion and that there will be a standards on which to base the actions of the future Hong Kong Special Region government. This also was intended to bolster the confidence of the Hong Kong people.

Deng Xiaoping had a very principled view of the Basic Law. These views were first transmitted internally. He later spoke of them openly when he met the entire Basic Law drafting committee on 16 April 1987. He included the following general points: 1) It should not be too detailed. It should be less detailed and more general, more in principle. 2) Hong Kong's system should not be completely westernized and should not completely copy the West. I do not approve of using "three independent branches." 3) I do not approve of conducting immediate general elections. If there are to be general elections, we advocate making a gradual transition into this, one step at a time. 4) The central government will have some control over the Special Administrative Region. In general, this will be divided into three levels. The central government will not interfere and does not need to interfere in the specific affairs of Hong Kong. Will events occur in Hong Kong which would harm the nation or the basic interests of Hong Kong? Can we assume that Hong Kong will have no disturbances and no harmful forces? Will problems arise in Hong Kong which only Beijing can resolve? After 1997, if there are those who curse China or curse the Chinese Communist Party, we can allow this. But what if this becomes action and Hong Kong begins to oppose the mainland under the pretense

of democracy? Then we will have to intervene. How to intervene? First it will be Hong Kong administrative organizations which intervene. It will not necessarily require central government troops to appear. Only if there are riots or major riots, will stationed troops be mobilized. In any case there will be intervention.

These views of Deng Xiaoping became the principles adhered to by the Chinese drafters of the Basic Law. They also became the central issue of conflict between China and Hong Kong during the drafting of the Basic Law and the development of events in Hong Kong afterwards. China's organizational participation in the drafting of the Basic Law indicates China's emphasis on the enactment of a Hong Kong Basic Law and prudent, meticulous attitude towards that Law.

The specific drafting of the Basic Law was led by the State Council's Hong Kong and Macao Office. Under the leadership of Ji Pengfei, the detailed work was the responsibility of then vice director of the Hong Kong and Macao Office Li Ho and Secretary Lu Ping. After the drafting committee was established, Li and Lu became the chairman and vice chairman, respectively, of the committee. Mao Jun-nian was also a vice chairman of the drafting committee, with the responsibility of liaison with the Hong Kong drafting committee.

The sequence of steps taken under the State Council's Hong Kong and Macao Office was basically as follows: After research and investigation, a draft was proposed, and Ji Pengfei called a meeting of relevant units to discuss the proposal. In addition to the authorities of agencies relevant to Hong Kong and Macao, participants included the Hong Kong and Macao Office, the Ministry of Foreign Affairs, the Foreign Affairs Office of the State Council, the Hong Kong branch of XINHUA, and the Chinese representative to the PRC-UK United Liaison Team. [Installment No. 42]

Article Debates Role of Government, Party

'Integration' Challenged

94CM0083A Beijing SIXIANG ZHENGZHI
GONGZUO YANJIU [RESEARCH IN
IDEOLOGICAL-POLITICAL WORK] in Chinese
No 10, 8 Oct 93 pp 12-13

[Article by Zhong Zujian (6988 4371 1696): "The Proposal of 'Integration' of Party and Government Is Unscientific"]

[Text] The Central Organization Department's Party Building Studies Institute recently held a forum to discuss the matter of the relations between the party and the government. The participating comrades discussed their views from their various perspectives, in combination with the conditions that they personally understand and were familiar with. These are summed up in the following three key points:

I. "Integration" of Party and Government Is Inappropriate

The participating comrades held that "integration" of party and government is both unscientific in theory and harmful in practice, being unsuited to enterprises, as well as inapplicable to government organs. Their grounds for this were as follows:

The separation of party and government functions is a key principle that should be adhered to by the ruling party establishment. A professor at the Central Party School said that: The need for party and government functions to be separate was Lenin's idea. As to the resolution of the relations between the party and the government, Lenin said that the party and the Soviets were both needed, and that it was necessary for them to work together. The separation of party and government functions was also a key part of the thinking of comrades Mao Zedong and Deng Xiaoping. Since the Third Plenary Session of the 11th CPC Central Committee, all Central Party documents and meetings have confirmed the separation of party from government. But while this shows that the theory of separation of party and government functions is correct and should be adhered to, the separation of party and government functions should not be understood to mean that party and government work is absolutely isolated. Premised on separate functions, the party and government must work together focused on the key task of economic development. In enterprises, the coordination of party and government work should explore a new path under the guidance of the spirit of the "three sentences" set forth by the Central Committee. Some enterprises have summed this up from practice in three words: 1) "Separate," meaning that party and government functions must be separate. 2) "Consistent," meaning that general working ideas and objectives must be consistent. 3) "Mostly," meaning that the work of each party and government operational department has its own particular emphasis, mostly within its own scope of responsibility. As used here, "separate" is relative, "consistent" is absolute and unconditional, and "mostly" is conditional and within a prescribed scope.

The term "integration" does not conform to materialist dialectics. This so-called "fusing" means downright merging into an organic unity in both essence and appearance, which is unscientific when applied to the resolution of the relations between the party and the government. One professor held that: The matter of the relations between the party and the government is one of a division of labor, not a system issue. The whole party must now be focused on economic development, around which focus all work of both party affairs and economic departments must revolve. While enterprise party organs, administrative bodies, and entrepreneurs are all emphasizing economic development, each has its own particular methods and work emphasis, which is the only way to better arouse the full initiative of all parties to achieve rapid economic development. If party and government functions were "fused" into one, "fusing" diversified means and methods into a uniform method

and way, the consequences would naturally not be good. A county party committee secretary summed up his own work as "running on three tracks," i.e., official circles, markets, and examination halls. This meant running around raising funds for projects, learning about market conditions to find markets for products, and emphasizing the training of cadres in market economy theoretical studies and operation and management skills. While this was apparently a party committee emphasizing economic work, it was actually this particular party committee secretary doing what an enterprise administrative staff should have been doing, leaving leadership by the party to exist in name only.

The consequences of "integration" would be less pro than con. At the forum, certain comrades analyzed the "advantages" of the publicized "integration" in certain areas and units. Some comrades said that one of the key reasons for the term "integration" was to facilitate coordination of party and government relations. While their subjective intention may have been good, i.e., to resolve the matter of "two skins," the real consequences would certainly not be good, being likely to downplay party concepts, lower the party's public prestige, and even shake the party's ruling position. The key to good relations between the party and the government lies in the quality of party and government cadres, particularly their political quality. All units with better quality party and government cadres, regardless of organizational setup, can work together with one heart. Otherwise, separate organizations may see disputes over names and powers, while organizational merging might result in the government replacing the party. Other comrades held that while the merging of party and government might resolve personnel conflicts, whether it could ensure that the party organization's crucial political role is brought into full play is another matter. In the party organization's crucial political role, what is emphasized is the overall organizational role, not merely the individual role of a particular secretary. If the party's organizational structure was "fused" away, it would be very hard for the party organization to bring its role into full play, and it might even be weakened. Moreover, as individual energy is limited, emphasizing both production operations and party building under complicated market economy conditions would require a group of complex cadres of extremely high political and professional competence, while the current reality is that such cadres are very few, so that under "integration," it would be hard to ensure that the party establishment is not weakened. Yet other comrades said that: As "integration" would overcentralize power, it could easily result in a patriarchal system with one person laying down the law, to weaken the party's democratic centralism; "integration" would weaken restraint forces, making self-oversight impossible, as well as exacerbating corruption; and "integration," in which one-person decision making would grow, would also abet rule by man, being adverse to rule by law. In short, there would be less pros than cons in taking "integration" as a structural reform model to be disseminated.

II. "One Shoulder Carries" Differs From "Integration"

In certain governments or enterprises, having a single really good individual in charge of both the party and government is what is commonly called "one shoulder carries." Comrades participating in such a system have held that "one shoulder carries" differs from "integration." "One-shoulder carries" is merely one really good individual in charge of both the party and government, while "integration" is all party and government cadres holding concurrent jobs; in "one shoulder carries," there is still a division-of-work responsibility by deputy cadres in party and government functional departments for party and government work, while "integration" completely mixes up party and government responsibilities; "one shoulder carries" streamlines party organs but keeps essential ones, while "integration" completely merges party and government functional organs into one.

The participating comrades held that: The "one shoulder carries" leadership style did not just appear, but has been in use at all times. It is not an artificially mandated and prescribed pattern, but rather one that has evolved naturally from the realities of particular units. As it has been due to either the temporary lack of a suitable person for the job, or leadership conflicts that are hard to reconcile, or units and numbers of people being too small to make it necessary to install separate party and government hands, "one shoulder carries" should not be regarded as a standardized leadership style to be widely disseminated.

In practice, while the "one shoulder carries" style is feasible for certain qualified departments or enterprises, it is still not perfect. Some turn the "one shoulder carries" into a "one-sided bias," emphasizing economics, while neglecting party establishment. Some comrades have said that it was not their intent to consciously weaken the leadership of the party, but was rather a case of limited energy and capability of one individual making it hard to avoid losing sight of one thing while attending to another. One party committee secretary of a large state enterprise said with much feeling that: If I was now made to practice "one shoulder carries," I would have to focus 99 percent of my energy on the economy, leaving only 1 percent for party building. This is because I have been a party committee secretary for so many years, so I am tied to strengthening the party establishment.

All at the forum held that leading party and government work units practicing the "one shoulder carries" should have the following qualifications: 1) They must be both familiar with party affairs work and understanding of the complex type of cadres with strong party spirit, professional skills, and command ability to be selected for production operations, to keep "the party replacing the government" or "the government supplanting the party" from occurring in work practice; 2) party committees and administrative departments must be separately

equipped with powerful deputy cadres, in order to prevent losing sight of one thing while attending to another due to the inadequate energy of one individual, which would create toughness in one area but laxness in another; 3) Higher level departments must reinforce their leadership and oversight so that they can promptly call attention to and correct symptoms of "one person laying down the law" and the "patriarchal system" as soon as they are discovered, in order to ensure implementation of the democratic centralism principle.

III. The Setup of Party and Government Organs as Economic Entities Should Allow for Diversification

As reform and opening has grown in intensity, the internal structures and external climates of Chinese enterprises in transition to the market have both become more complex. Faced with these conditions, how to set up party work organs and ways to bring the crucial political role of the party organization into full play are still in an explorative stage. The participating comrades discussed the following views directed at this matter:

We need to sort out our thinking and reach a consensus. A professor at the Central Party School held that: As the matter of the setup of party and government organs is not one of system, but rather one of party-government relations, considering it in isolation cannot resolve it. While the terms "integration" and the "one shoulder carries" were both brought up to resolve conflicts between the party and the government, these methods certainly cannot actually resolve such conflicts, but can only offset or avoid them. As our party is the ruling one, why has it never been able to resolve well this matter, while multiparty ruling coalitions in Western nations can work together in cooperation? This is due to our lack of legal institutions. Our organizational setup relies on rule by man, with holding of concurrent posts and partnerships being arbitrary. Under rule by law, how could a party committee secretary serve concurrently in an administrative job? Similarly, how could a factory manager or director not elected to a party committee serve concurrently? Legal institutions can prevent such "stirrings." This professor also said that: The current guiding ideology on the matter of party-government relations is in particular confusion, which is reflected mostly in the lack of consensus on the principle of separate party and government functions. So in order to reach a consensus on bringing order to party-government relations, we still need to spend a lot of energy on investigation and study. Another associate professor held that while the current emphasis is on economic development, the longstanding idea that the party is the party and administration is administration has not yet been changed over. While the party must not relax its leadership of economic work, leadership methods can be explored. Superstructure reform is now lagging, still unsuited to the needs involved in developing a market economy. An enterprise party affairs worker also held that: As leadership system reform within enterprises is not now the number one problem, with the major conflict being the clash of the

conversion of enterprise operating forces with government functions, a resolution to this conflict will mean speeding up the pace of legalized management.

We must persist in proceeding from our realities, instead of "acting indiscriminately." This was a unanimous view of the participating comrades. All held that it is wrong for the party to replace the government, with party committees being responsible for all administrative affairs. However, it is also wrong to merge the party and government, with the government replacing the party. Such matters require a sober understanding and taking of precautions. A comrade from the Beijing municipal party committee organization department said that: As to all types of enterprises in the Beijing Municipality, the separation of party and government organs has been done well by some, but poorly by others; one person holding concurrent party and government leadership posts has worked well in some cases, but caused problems in others; in certain other small and medium enterprises, party and government functional departments have long practiced one set of staff under two trademarks very well. This shows that the particular conditions of all enterprises vary, so that the leadership style adopted should also vary somewhat. We should separate or merge as necessary. As long as reform conforms to the principles of "streamlined, uniform, and efficient," the leadership style it chooses is feasible. It is not necessary to favor a particular pattern or "act indiscriminately." There is even less need to openly propagandize about "the party residing in the government," "party-government merger," or "party-government integration." Certain enterprise comrades held that in the course of converting operating forces, the setup of enterprise party and government leading organs should be open to experimentation. As enterprise operating forces are converted, the ways and means of party organizations bringing their crucial political role into full play will see a diversification trend, which will require paying attention to investigation, study, and conscientious summing up of experience.

We need a stable reform orientation to prevent "bursts." At the forum, many comrades held that the current increased advocacy by a few periodicals for the "integration" model is unsafe. Some comrades said that: As "integration" is also only an exploration, giving wide publicity to this method could make grassroots comrades think that it is approved by the Center, encouraging certain enterprises to act not out of their own realities, but to blindly copy instead, resulting in a "burst." Other comrades said that neither the center or localities should chant arbitrary slogans which once set forth easily cause "stirrings." So we should experiment more and mention "fusing" less, which is the only way to be objective. Yet other comrades hoped that leading organs, based on thorough investigation and study, would come up with a uniform and scientific term for the matter of party-government relations, to help in reaching a consensus and taking concerted action.

Public Opinion on Single-Person Responsibility

94CM0083B Beijing SIXIANG ZHENGZHI
GONGZUO YANJIU [RESEARCH IN
IDEOLOGICAL-POLITICAL WORK] in Chinese
No 10, 8 Oct 93 pp 14-15

[Article by Li Jian (2621 0313): "Public Opinion Varies on 'One Shoulder Carries'"]

[Text] In state enterprises, "one shoulder carries" is now a very "hot" topic. In a recent investigation that I conducted in other parts of the country, the views that I heard from enterprise comrades on "one shoulder carries" varied.

Interesting Contrasts

It was still early in 1993.

Certain large state enterprises, in order to learn the ideological reactions of cadres and workers toward "one shoulder carries," were holding a number of forums attended by various categories of personnel. In one of them, 10 of 12 shop foremen taking part actually disagreed with "one shoulder carries."

Their grounds were as follows: In the current state of affairs in which the whole company is completing a new round of the contract responsibility system, shop matters are causing all-day brain-wracking, tasks need to be guaranteed, management has to be emphasized, profits must be distributed, interests need to be harmonized, higher-level plans have to be implemented, and employee food and drink, bathroom and sleeping facilities, and other basic necessities all require attention, with even their family discord, infants' entry to kindergarten, and childrens' employment all needing looking after, not to speak of repeatedly retraining backward employees for new work, or the suffering and heartbreak involved in harmonizing internal conflicts.... With so many affairs to handle, how could one person possibly take care of them all? When one shop foreman learned that he was going to be subjected to "one shoulder carries," he actually got so excited that he went to the company leadership and demanded that he be provided with a full-time secretary at least.

On another occasion, however, 10 full-time shop party branch secretaries attending a forum actually "leaned to the other side," all demanding to practice the "one shoulder carries."

Why was this? It was mainly because they had had their fill through recent years of practice of the difficulties involved in full-time secretarial work! One secretary said that: "As secretaries now, we are seen by workers as unnecessary for wages and bonuses, not called on for housing and welfare benefits, to be called when problems arise, to be cursed when unable to solve them, and as downright inhuman. Oh, how awful!"

This is an interesting contrast.

"Dealing Well With Party-Government Relations"

In the course of my investigation and study, some comrades told me that when the key party and government leadership is separate, relations between the two parties are very hard to handle, as it is invariably necessary to consider "relations" first and work last. Even if both parties are of good quality, it is hard to avoid times when "both sets of chopsticks hit the bowl at once," not to speak of those enterprises in which one party is competent and the other not or both are lacking, so that grievances pile up. In "one shoulder carries," such conflicts disappear.

In addition to contributions to harmonizing party-government relations, comrades who hold that "one shoulder carries" is more pro than con also pointed out the following four "benefits":

1. It helps to improve efficiency. "One shoulder carries" reduces links, decreases levels, and cuts down on wrangling between the party and government, leaving work to go more smoothly and quickly.

2. It makes it easier to practice "one post, two responsibilities." Both factory managers (directors) serving concurrently as [party] secretaries and [party] secretaries serving concurrently as factory managers (directors) exercise two functions and undertake two responsibilities, so virtually have to break down these responsibilities to all enterprise cadres. Some comrades mentioned that in enterprises, as administrative and technical cadres make up the majority, it is very important to arouse their initiative to do ideological and political work. While the current emphasis is on building "general political work," this is often "wishful thinking," as it is merely a party-to-the-masses verbal emphasis which, while it may be shouted until one is hoarse, remains very hard to prove effective. "One shoulder carries," however, always makes it impossible not to obey the factory manager (director), which is better than when functions were separate.

3. It contributes to the joint cultivation of a single enterprise "field." The "one shoulder carries" system puts "dual-track" party and government onto a single track, merging two parallel "threads" into a single "rope," enabling both the party and the government to focus on economic work, jointly cultivate a single "field," and work together on the two civilizations.

4. It helps to improve the terms for building spiritual civilization. Comrades working as party-mass mouthpieces were very moved by this. Some said that the "one shoulder carries" provides ideological and political work and the building of the spiritual civilization with easy resolution of the necessary "inputs," making it easier to appropriate money, acquire materials, and improve conditions.

Of course, as the comrades who favored "one shoulder carries" also noted that this system might produce problems such as one shoulder hard and the other soft, or one

side heavy and the other light, they noted the need to pay attention to the quality matter.

"Even a Good Method Can Go Bad When the Wind Blows the Wrong Way"

At one forum, Zhao Anwu [6392 1344 2976], deputy director of the Changchun industry and communications department, gave a briefing on Changchun's industrial and communications enterprises.

Over 10 of Changchun's 130 large and medium enterprises are now practicing "one shoulder carries." In comparison to the whole northeast region, the percentage of enterprises practicing "one shoulder carries" in Changchun is small. The city has clearly pointed out that mergers or separations should be implemented as necessary, and as enterprise conditions vary, all methods can be experimented with, making possible overlapping posts, separate organizations, or "one shoulder carries." Enterprises have reacted well to these principles.

Zhao Anwu said that: "Even a good method can go bad when the wind blows the wrong way. While 'one shoulder carries' is working better in some enterprises, this is not to say that it is suited to all. A wind stirring up that would mandate this method could brew bad wine that would bring suffering to enterprises, in which area we have learned many lessons, so cannot continue to act in this way."

However, some areas are still addicted to "indiscriminate application." They blindly issue documents, requiring certain numbers of enterprises to practice the "one shoulder carries" for prescribed periods of time, even lacking conscientious investigations and rigorous tests, while continuing to plan the "one shoulder carries" for certain enterprises by name.

In a large enterprise in a certain city, key party and government leaders have worked in close cooperation, with many large newspapers reporting their experiences in recent years, and enterprise production operations going very well. The municipal leadership went to the factory to announce that the factory leadership would remain unchanged, hoping that all would work as one in striving to complete 1993's tasks. However, before 20 days had passed, the higher authorities sent the organization department to the factory to conduct a public opinion poll on "one shoulder carries," leaving all in a state of confusion. Then not long after, as the party committee secretary had not yet made plans for it, it was announced that this factory was going to institute "one shoulder carries."

Some comrades asked: On the enterprise leadership system matter, when are we going to be able to proceed from our realities? For instance, as conditions vary from large and medium to small enterprises, industrial and communications to commercial and trade enterprises,

and central to local enterprises, with even similar enterprises being characterized by many differences per particular enterprise, and since the management responsibility system can take such diverse approaches, why cannot the leadership system be "tailored to fit," instead of being forced to "indiscriminate application?"

"We Must Not Dispose of Matters Through Proclamations"

I found out in my investigation that some enterprises now practicing the "one shoulder carries" came to do so through orders and proclamations by the authorities. Restraint forces within enterprises, many key matters, and basic natural courses are all subject to the "carrier's" decisions. Comrades from these enterprises worry that if this goes on for long, it will be impossible to avoid problems.

However, certain other enterprises have also taken more initiative in this area, not waiting or depending, but rather striving to explore the operating forces and working procedures of "one shoulder carries." For instance, once the Jihua Co began to practice "one shoulder carries," studies brought it to very quickly publish the "Rules of Procedure for Party and Government Leading Groups in the Jihua Company," setting forth quite clear provisions on matters such as the major responsibilities of those serving concurrently as party committee and manager secretaries, key procedural form and substance, major business procedures, and decision enforcement. For example, matters such as the form and substance of official party committee business, how often meetings of party committee standing committees and plenary sessions are to be held, and conference substance, form, and decision making methods were all set forth in specific and detailed provisions. As to grassroots party branches, they discuss decisions on key issues in eight areas, such as the drawing up of annual, seasonal, and monthly production operation work plans and goals, long-range unit development plans, employee training, wage adjustment, housing, and bonus distribution plans, in which grassroots Party branches must participate.

"The Party Has Increasingly Less To Do"

Some workers and cadres hold that "one shoulder carries" is a retreat from the "three phrases" enterprise leadership system, with each step backwards being a deemphasis of the party establishment.

They felt that while the "one shoulder carries" system has useful parts, its defects are also obvious:

1. It abets arbitrary decision making by individuals. Some comrades put it this way: While the factory manager (director) responsibility system has already given individuals the authority of independent dealings from a system perspective, it is now also necessary to give them "party authority." But as China is a country that has been through thousands of years of feudal autocracy, in which the "patriarchal system" of "one person laying

down the law" already has deep social and ideological roots, how many could actually make democratic decisions while holding such great power if "one shoulder carries" was practiced unchecked?

2. It makes guaranteed oversight impractical. Certain comrades held that: While the crucial political role played by enterprise party organizations is in line with the party constitution and rules, when there are laws for administration but none for party organization activities and development, and as the "crucial" political status and guaranteed oversight role is already a bit illusory, going on to practice "one shoulder carries," leaving the party organization with even less authority, would make it very hard for the party organization not to become an administrative "subsidiary." One party affairs worker said that since reform and opening, enterprise party organizations have retreated step by step, party affairs have decreased one by one, and party prestige has declined bit by bit. Since many rural party organizations have been broken up, will not any further retreat by enterprise party organizations likely collapse the very foundation of our party?

3. It exacerbates the "proficiency weakness" problem. Some comrades hold that while it is party committee

secretaries who are doing "one shoulder carries," they are objectively forced to focus most of their energy on production operations. When they find themselves handling large amounts of routine matters, they have no time to attend to the building of spiritual civilization, take part in training, or go to meetings, leaving them short on macroeconomic study, and even shorter on specific leadership. If the building of spiritual civilization is nothing but passing out money and materials, this can only exacerbate the "proficiency weakness" problem. Moreover, are there not some already who deemphasize spiritual civilization?

4. It results in "integration." Many comrades hold that "one shoulder carries" is the first step toward "integration." As long as party and government leadership and decision making are being merged, many enterprises will gradually merge their party and government organs and functions, thus making a transition to "integration." This is how the government replacing the party, with "the party residing in the government, and party-government merger," will succeed. If this goes on, the weakening of party work, deemphasis of party concepts, and lowering of party public prestige will also become inevitable.

NATIONAL AFFAIRS, POLICY

Research Group Issues Economic System Reform Plan

94CF00334 *Chongqing GAGE [REFORM] in Chinese*
No. 5, 20 Sep 93 pp. 18-29

[Article by Lou Jiwei (2869 4949 0251) and Li Keqiang (2621 0344 1627), Task Force on Comprehensive Plan for Chinese Economic System Reform: "Basic Approach for Building a New Macroeconomic Regulation and Control, and a State-Owned Assets Management System"]

[Text] The 14th Party Congress made clear that the goal of China's economic system is the building of a socialist market economy. In order to realize this goal, we believe that China's revenue, fiscal, financial, and investment control systems should be completely reformed as quickly as possible to provide a framework for a national macroeconomic regulation and control system in the socialist market economy within three to five years. Reform of the state-owned assets control system should also be pursued actively at the same time to build a new foundation for the equity system, in which the public ownership is paramount in the operation of the market economy.

1. Intensification of revenue, fiscal, financial, and investment control system reform and promotion of state-owned assets control system reform are urgently needed for the building of a socialist market economic system, and for solving deep-seated problems in development of China's economy.

Both reform and opening to the outside world, and modernization have entered a new era since 1992. The overall situation in reform and development is good, but some deep-seated difficulties and problems remain in the operation of the economy. One such problem is that no effective macroeconomic regulation and control system, and no microeconomic restraint mechanism have been built. A new peak in increased total social demand is forming. Second, demand inflation and structural imbalance exist at the same time. Anomalies in the product mix, the industrial structure, and the enterprise organizational structure have improved but little. Structural problems further complicate overall balance. Third, simultaneous with high speed growth is continued not very high overall economic returns, steady rise in the losses of state-owned enterprises, and serious problems of enterprises being behind in the payment of their obligations. Fourth, the fiscal and financial situations are grim. The central government's macroeconomic regulation and control capabilities are extremely weak. On the one hand, the central government fiscal deficit is on the rise. The central government is able to obligate only about 38 billion yuan each year for key capital construction projects. It is unable to change the serious backwardness of the basic sector. On the other hand, structural readjustment pressures are transferred to banks,

thereby intensifying the tendency toward monetary financing of credit. The central bank's difficulties in guarding the main gate of money supply increase inflationary pressures.

The current economic situation suggests that inflation has begun to appear. Naturally, emergency measures will have to be taken at once to deal with this to prevent worsening of the economic situation. The grim reality is that given the present system, the measures that we can take can play only a limited role. The institutional origins of the large ups and downs in the economy remain. For the medium and near term, fundamental measures are acceleration of macroeconomic system and enterprise system reform, readjustment of the benefit stimulation mechanisms of enterprises and governments at all levels, improvement of risk restraint mechanisms, and providing the policy tools needed for effective indirect macroeconomic regulation and control in the building of an overall system to realize policy goals.

The existing macroeconomic system suggests that the main causes for the above difficulties and problems are as follows:

An inequitable tax system manifested primarily in a too narrow tax base, too much reliance on processing industries, and inability to adjust to new changes in sources of revenue, which lead to uncertain government revenues. Second, taxation is used too much to readjust the industrial structure and the functions of enterprises under different forms of ownership. Too much tilting of revenue policies makes for numerous taxative items and tax rates, and uneven tax burdens. Third, excessively tilted revenue policies actually not only make attainment of policy goals difficult, but damage the unity and the standardization of the tax system. They provide many loopholes for various forms of tax evasion and tax cheating, which increases revenue collection and administration difficulties.

Neither the existing "fiscal contracting" in the form to be promoted fiscal system of "contracting separate taxes" (fenshuo binguan) provide an institutional basis for regularizing the fiscal distribution relationship between the central government and local governments. First of all, the dividing up of fiscal revenues does not eliminate administrative subordination, it is detrimental to separation of government administration and enterprise management. Second, turnover taxes, which have such a great effect on the economic structure, account for an overly high percentage of local fiscal revenues. This results in redundant construction, rising far high speed development, intensification of economic fluctuations, and regional fragmentation. Furthermore, the haggling back and forth and the slow contracting of base figures that attends fiscal contracting create a repressive mechanism in fiscal revenues that denies the central government sufficient financial strength. Thus, the central government's ability to apply fiscal measures to readjust the structure becomes increasingly weak. Finally, as the economy grows, revenues increase relatively slowly. In

1992, a "real estate craze" occurred, enterprises profits increased, and industry grew by 20 percent, but between January through October, both land use taxes and income taxes declined, and product taxes increased only 5.2 percent. Meanwhile, fiscal expenditures increased much too fast, requiring expansionist fiscal policies. During 1993, fiscal revenues that are lower than production growth has been an even more serious problem. During the first quarter, the increase in fiscal revenues was only one-half GDP growth and less than one-third industrial production growth.

The functions of financial institutions are not well-defined; they lack vitality. First, the central banks bears too much of the burden of readjusting the economic structure. Its wider operating tasks frequently conflict with its goal of controlling total demand. Second, it mostly relies on administrative fiat to regulate and control the amount of currency. It lacks tools for indirect regulation and control of currency policy, which means it cannot flexibly regulate total demand. Third, the operating mechanisms of the specialized banks still have a pronounced administrative coloration. They lack vitality. These banks have a very large number of suspense accounts, questionable debts, and bad debts. The quality of their assets has further declined. Therefore, when total demand inflates excessively, effective currency policy tools are lacking, and the financial institutions needed to implement currency policy goals are also lacking. The banks have to fall back on mostly administrative and command-style methods to control total demand. As a result, they cannot control currency outside plan, and the key construction within state plan that they can control is damaged.

The planning system has not freed itself from control of microeconomic activity. It continues to use static plan balance control methods, devoting much energy to setting norms, apportioning investment, approving projects, and dividing up foreign exchange. Its overall ability to coordinate macroeconomic policy methods is weak.

Investment decisionmaking remains overly concentrated in government agencies at all levels. Control methods remain mostly administrative fiat, control of scale, and the examination and approval of projects. The most glaring problem is that investment decisionmaking, increasing funds, construction, production and operation, and even debt repayment are divorced from each other. A clear-cut investment responsibility and risk limiting mechanism is lacking. This results in mindless investment, redundant construction, low returns, and serious waste. As prices are further decontrolled, actual economic operation—particularly the greater degree to which enterprises' business activity is controlled by the market—will greatly accelerate. If reform of macroeconomic institutions does not keep pace, existing control system frictions with enterprises and markets will become increasingly greater, directly impairing the sustained and steady growth of the national economy.

Therefore, further intensification of macroeconomic regulation and control system reforms has become an urgent need in building market economy institutions, and in ensuring China's steady high speed economic growth.

The lag in reform of the equity system in state-owned enterprises is one of the basic reasons for the various economic problems cited above. So long as equity rights of state-owned enterprises are ill-defined, so long as there is no separation of government administration and enterprise management, and so long as limitations on authority are not spelled out, formation of true markets is difficult. It cannot be expected that enterprises will fully respond to macroeconomic regulation and control signals. Moreover it is only enterprises whose equity rights are clear, that make their own operating decisions, and that bear responsibility for their own profits and losses that are the heart of a market economy. However, efforts in the microeconomic realm to reform the enterprise operating mechanism cannot change this situation fundamentally. Reform of the state-owned assets control system is necessary to achieve this. It is necessary to reconstruct the state-owned enterprise equity rights system by transforming the state-owned enterprise ownership structure.

2. The Basic Pattern of New Institutions for State Macroeconomic Regulation and Control, and the Goals of Institutional Reforms

In view of the needs of a market economy, and given the stage of development of China's economy, we have the following preliminary ideas about the goals of national macroeconomic regulation and control, its basic functions, and the division of labor among government agencies, as well as the goals of system reform.

1) Main goals of state macroeconomic regulation and control: to regulate total demand so as to ensure economic stability and growth, as well as to keep a balanced balance of payments; to remedy shortcomings of the market mechanism in order to provide products and services to society, to regulate the distribution of income, to ensure social equality, and to advance balanced regional development; and adoption of appropriate industrial policies to promote structural optimization, and to improve total supply capabilities.

2) Functional division of labor pattern for main macroeconomic policies: Regulation of total demand employs mostly monetary policy; proper regulation of the economic structure employs mostly fiscal means; industrial policies are mostly functional policies. Tilt policies that are broad in scope are not used, the goal being to promote transformation and upgrading of the economic structure. The taxation system is gradually moving toward a neutral role.

This pattern contains the following several specific ingredients:

First, the main function of the taxation system is to provide government with a stable source of revenues, and to create an equal environment for market competition. Taxation policy mostly regulates income distribution. The use of tilted taxation policies to allocate resources is gradually giving way to a taxation system that plays a neutral role. In this regard, for a fairly long time to come, indirect taxation in which added value taxes are the main form will account for a large percentage of all taxation. Land taxes and resources taxes should occupy an important position. The percentage of tax revenues obtained through the enterprise income tax will decline, and the position of the individual income tax will gradually rise, ultimately becoming one of the main forms of taxation. There will be a gradual transition from mostly indirect to direct taxation. In order to ensure a broad tax base and steady revenues, for the present it is necessary that indirect taxation, mostly in the form of added value taxes, account for a fairly large percentage of revenues. Furthermore, the added value tax is by nature a tax levied on elemental [yaosu 6008 4790] income. It differs fundamentally from turnover taxes such as product taxes. It also avoids the pitfalls of turnover taxes in the form of multiple collections and distortions of the structure.

Second, the main function of the fiscal system is to promote balanced regional development through the redistribution of fiscal revenues and the use of government funds. The fiscal system provides basic public facilities and social services, and sustains long term stability and balanced growth of the economy. It also regulates the level of total demand through the use of fiscal policy. Performance of this function requires a standardized tax apportionment system that spells out the powers and fiscal authority of the central government and local governments to ensure the eager participation of both. In the organization of fiscal revenues, the central government must receive the biggest percentage. This principle must be used as the basis for building a fiscal revenues transfer payments system in which the central government makes transfers to local governments, thereby enhancing the central government's regulation and control capabilities. This also builds a new long-term finance capital system backed by national credit that soaks up long-term capital for which compensation is paid, using this capital to build the basic facilities and the basic industries for which the capital recovery period is overly long. In this way a new fiscal system can be fashioned that can pretty well standardize relations between the central government and local government, rather fairly balance the fiscal abilities of different regions, and effectively adjust the economic structure.

Third, the central bank holds a crucial position in the financial system. The central bank's monetary policy is a major means of regulating and controlling the macro-economy. Monetary policy is primarily a restraining policy whose goal is to stabilize the currency, this stabilization serving as a prerequisite for ensuring total supply capabilities. The central bank has to supervise

and control the banking business and safeguard financial order; however, it may not interfere in the business of the specialized banks, much less can it directly engage in the business of the specialized banks. The central bank must not use credit granted for policy reason for direct regulation of the economic structure. It must build a highly trained, and highly effective central banking system to develop the building of national and local commercial banks, and to establish special banks that function in support of policies.

Fourth, the main function of the planning system is to study long-range strategy, to draw up long-term plans and industrial policies, and to do a good job of forecasting and balancing development of the economy. In order to do this, new planning concepts, improved planning methods, and a change in the focus of the planning sector are needed.

Fifth, is decontrol of virtually all prices to form a price formation mechanism in which the market mechanism decides prices for the most part. The country's price policies consist mostly of: price support for basis agricultural products, and regulation and control of the prices of sectors enjoying a natural monopoly, exercising regulation and control of the overall price level and trade monopolies through total demand policies and monopoly measures.

3. Basic Tasks and Steps To Be Taken in Macroeconomic Regulation and Control System Reform

1) Tasks and Steps To Be Taken for Tax System Reform.

Need to build a new broadly based taxation system in which the tax burdens are fair, and collection and administration are effective.

1. Setting up a new taxation system requires readjustment of the present turnover tax structure, changing the present dual system of taxation in which domestically capitalized and foreign capitalized enterprises are taxed differently, and standardizing the turnover tax system. The division of enterprises for income tax purposes in terms of whether they are internally or externally capitalized must be changed, and the two different income tax systems—one for Chinese citizens and the other for foreign citizens—must be changed too, a unified enterprise income tax and individual income tax created. The land tax and the resources tax must be broadened; tax burdens must be made more equitable and tax concession policies must be revamped. Methods for the uniform collection of social security taxes must be studied.

Fulfillment of the above tasks will fashion a new tax structure. Not only will the tax base be broadened, but steady revenues can be ensured. This will hurt industry but little, but it will provide considerable leeway for the central government and local governments to split up the kinds of taxes each collects and to standardize the tax apportionment system. In addition, standardized added value taxes, and uniform income taxes will set the stage for effective tax collection and administration. Once a

new taxation system has been put in place, efforts must be made to ensure that fiscal revenue as a percentage of national revenue is higher than it now is.

2. Taxation reform and price reform more or less at the same time.

While standardizing the added value tax, the range of product tax collections should be correspondingly adjusted. This is because with the increase or decontrol of basic product prices, the tax rate on products from basic sector processing industries will become too low or too high. Readjustment of product taxes will then become an urgent task of the first order. The tax on a small number of luxury goods will be retained, but changed to an excise tax. Taxes on other products will be replaced by a 1 to 2 level tax rate added value tax, a uniform tax rate applied across the board, the calculation and collection of the added value tax standardized, and uniform tax collection methods that provide for the notation of taxes on receipts and the deduction of taxes used. This method will establish a new pattern of indirect taxation, which will account for a substantial percentage of all taxes to ensure steady fiscal revenues.

At the same time, separate payment of taxes and profits, after-tax debt repayment, after-tax sharing of profits, and the perfection of debt repayment and profit sharing based on the summarization of experiences should be instituted to deal with distribution between the state and state-owned enterprises. Uniform financial accounting regulations can serve to merge the income taxes of Chinese and foreign capitalized enterprises thereby bringing tax rates in line in fact as well as in name, and implementing reforms that unify the Chinese and foreign individual income tax.

- Income differences after reform of the land tax and the resources tax, widening of land tax and resources tax coverage, and readjustment of the decontrol of prices of primary level products. Efforts should be made at once to reform land taxes in light of the current development of real estate and development zones, taxes levied on land sales, land use, land transactions, and land appreciation to increase fiscal revenues and to ensure fair distribution of social resources.

Re-examination of customs duties to bring them in line with price reform, domestic tax system reform, and requirements for entry into GATT, readjusting and reforming tariffs at once. Nominal tariff rates should be gradually reduced, and tax reductions and exemptions for various items should be controlled, fundamentally changing the present irrational situation of very low actual tariff rates and overly high nominal tariff rates. The nominal tariff rate in China today averages 22.5 percent, but because of various reductions and exemptions, the actual average import tariff rate is only about 10 percent, which is lower than the average 14 percent of developing countries today.

Separation of national tax collection agencies and local tax collection agencies. In accordance with the principles of centralization and efficiency, all possible should be done, first of all, to legislate the centralization in the central government of all taxes that should be under centralized national control. Then the kinds of taxes that local jurisdictions can collect more efficiently should be turned over to them for collection for appropriate expansion of the local tax system. Local jurisdictions should have limited authority to legislate local taxes. Separate central government and local government tax collection systems should be set up, and tax reductions and exemptions strictly controlled. The contracting or disguised contracting of turnover taxes must be resolutely halted.

2. Tasks and Steps To Be Taken for Fiscal System Reform

1) Institution of a standardized tax sharing system, establishment of a fiscal revenues transfer payments system, and operating a system for long-term financing for policy reasons are basics tasks in fiscal system reform.

Institution of a standardized tax sharing system requires that functions of governments at all levels be well defined, powers apportioned on the basis of functions, and payments apportioned on the basis of powers. The general principle for the apportionment of powers is that governments at all levels not interfere with the operation of enterprises. In the apportionment of powers between the central government and local governments, the central government is responsible for stability of the social order and for ensuring a unified nationwide market. In addition, it is responsible for national infrastructure that cuts across local jurisdictional lines, and it is responsible for modulating the macroeconomic structure of regions and industries. Local governments are responsible for matters having a direct bearing on local socioeconomic development, principals of which are local infrastructure, environmental control, and social services in the fields of science, education, culture, and medical care, local income distribution and social security policies, promotion of the development of tertiary industries and other commercial endeavors, and improvement of the investment climate.

Operation of a standardized tax sharing system also requires apportionment of revenues between the central government and local governments. The largest percentage of revenues must go to the central government. The present system of contracting the division of income between the central government and local governments must be changed, and the apportionment of income tax revenues on the basis of enterprises' administrative subordination must be demolished. Turnover taxes cannot be shared in common by the central government and local governments in all cases. The sharing of revenues in common should be reduced or eliminated.

Using a division of disbursements and receipts among governments at all levels as a basis, some of the revenues

that the central government controls should be used to balance the fiscal capabilities of local jurisdictions for the building of a mechanism whereby the central government makes transfer payments of fiscal receipts to local jurisdictions. This means, in effect, that the central government will subsidize the different local jurisdictions on the basis of certain standards (such as population, topography, and per capita GNP).

Building of a new mechanism for long-term financing for policy reasons. The basic function of long-term financing for policy reasons is to enhance construction of infrastructure, and remedy budgeted funds shortfalls. Long-term financing for policy reasons uses mostly postal savings, retirement funds, and government debentures as the main sources of funds, paying compensation for their use. Compensation for financing costs out of public funds provides security, thereby improving financing conditions. The main things financed are basic public facilities, basic industries, and long-term export credits for which the turnover periods are long, profits low, and risks great. Public projects from which investment cannot be recovered out of profits are financed out of government budgeted appropriations.

No longer may government finance departments interfere in the financial affairs of state-owned enterprises. Financial accounting systems that approximate international standards have been promulgated, and independent accountants are playing an increasing role. Therefore, agencies in government departments that control the finances of state-owned enterprises should be abolished, the functions of fiscal, revenue, and state-owned assets control units rationalized.

2) Fiscal system reform measures must be coordinated with price and tax reforms. Reform of the tax sharing system must move ahead step by step.

- Gradual elimination of subsidies for losses resulting from policy reasons as a follow-on to price and revenue reform.

Reform of a standardized revenue-sharing mechanism in two steps. Because of the difficulties involved in dividing up power and building a transfer payments mechanism, revenues should be tackled first and disbursements later. As a first step, the base figures for fiscal disbursements at all levels should not change. Changes should be made along with reform of indirect taxes and the income tax, the fiscal revenues relationship between the central government and local governments changed first. In view of the different effects of taxes on the economic structure and fiscal revenues, and bearing tax collection and management capabilities in mind, the following several tax-sharing patterns should be set up for the main kinds of taxes: excise taxes, added value taxes, customs duties, and major resources taxes should go to the central government. Business taxes, real estate taxes, and social security taxes (or program evaluation and review technique funds) should revert to local governments. The central government should make up the difference

between local receipts and expenditures. At the same time, separate central government and local government tax collection agencies should be set up for the building of a dual collection and control system. As a second step, a standard mechanism whereby the central government can make transfer payments to local government should be set up, expenditure base figures and the make-up of expenditures prescribed as the powers of local governments warrant. The central government could use this mechanism to balance the financial resources of all jurisdictions, and to subsidize backward areas.

Simultaneous with reform of the tax-sharing system, the fiscal double entry budget system should be improved, the pertinent functions of fiscal units and planning units readjusted and merged for a fashioning of a long-term fiscal financing plan. Banks that serve policy requirements, such as import-export banks, and development banks should be set up to serve as long-term financing organs for projects of a policy nature.

3. Financial System Reform Tasks and Steps To Be Taken.

1) Improvement of the central bank macroeconomic regulation and control mechanism. Building a highly professional, highly efficient central bank mechanism with central bank branches and sub-branches set up within large areas. The central bank should employ indirect regulation and control measures to control currency for the regulation and control of total demand.

- The central bank should gradually replace control of the amount of money in circulation with control of total credit, changing from primary reliance on direct credit limitation to gradual indirect macroeconomic regulation and control. By this is meant use of its own funds to increase or decrease the national debt, and to change the rediscount rate, as well as to use interest rates to adjust, regulate, and control the basic money supply, thereby achieving the goal of controlling the total money supply.

Revamping of the People's Bank organizational structure, eliminating all branches and sub-branches below the primary branch level, organizing one or several nationwide commercial banks and regional banks. The cash distribution business and the clearing business should be handled by the specialized banks.

Narrowing of the range of central bank business, turning over business done for policy reasons to banks established for this purpose, the central bank no longer handling special loans, and also no longer financing nonbanking institutions. The central bank should actively promote open market business, gradually increasing the percentage of national bonds among the central bank's assets. Simultaneous with a halt to government overdrafts on the central bank and the establishment of banks that serve policy purposes, postal savings might be made a source of funds for long-term financing of a policy nature.

2) Founding of banks to serve policy purposes, and development of commercial banks.

- Wholesale cutbacks in the policy loans business, setting up banks to meet policy needs, making policy loans a part of the system for long-term financing of a policy nature.

The business that specialized banks do for policy reasons should be separate from the business they do for purely business reasons. The organizational structure of specialized banks should be rationally decided, and their fiscal system and labor wage system should be reformed to make them truly commercial banks.

Control over the ratio between commercial bank assets and liabilities, and control over assets risk and liquidity to encourage commercial banks to compete with each other, competition spurring banks to improve their services.

3) The basic task in foreign exchange system reform is to make the renminbi convertible within certain limits for international balance of payments current accounts (including foreign trade, posts and telecommunications, communications, transportation, and the direct repatriation of profits from investment in China); and the reduction of government interference in the use of foreign exchange receipts.

- First is a change in the way in which the central government uses foreign exchange. Except for foreign exchange that the state needs for special purposes such as national defense and scientific research, which should continue to be supplied the state at the posted price, all other foreign exchange should be supplied at the negotiated price.

Acceleration of foreign exchange rate reform, the two-track foreign exchange rates being merged to a single track first of all for the development of foreign exchange markets. Then enterprises' retention of foreign exchange should be abolished, and the exchange rate allowed to float, the renminbi being freely convertible within certain limits for current accounts.

4) Separation of the banking business and the negotiable securities business, exercising independent supervision and control of the securities business.

4. Basic Tasks and Steps To Be Taken for Investment System Reform

1) Establishment of a tailored control investment mechanism.

Construction projects may be divided into three main kinds on the basis of the field of investment, return on investment, and the nature of profits.

First, for investment in competitive industrial sectors, and tertiary industries, the decision making authority of enterprises and banks should be gradually broadened, a

"declaration system" ultimately replacing the "examination and approval system." Government should no longer interfere in routine investment activities.

Second, nonproductive investment in public facilities such as building schools, hospitals, and cultural facilities should continue to be funded in the fiscal budgets of governments at all levels, and be directly controlled by government units in charge.

Third, investment in infrastructure and in large scale basic industries and sophisticated technologies, as well as regional development and construction should be supported by the state through loans for policy purposes. Such investment credit activities having to do with the national economic pattern should be made a part of the state's system of long-term financing for policy reasons. Banks set up to handle financing of a policy nature should exercise control in accordance with state regional development plans and industrial policies.

2) Proceeding on the basis of current conditions and possibilities, energies should be concentrated first on reform of the long-term investment loan system for policy purposes.

The first category of investment mentioned above should account for more than three-fourths of total investment. However, straightening out this investment activity will ultimately require changing enterprise equity rights, building a standardized fiscal revenue system, and improving the financial system.

The conspicuous problems existing today in state investment in construction and development, which the central government directly controls, and in the credit field are mainly the following: Lack of responsibility for investment and lack of a risk restraint mechanism; a shortage of funds, the central government lacking the ability to regulate the structure; fund raising, fund use, and fund administration mechanisms that do not run well; and central bank and specialized bank involvement in making loans for policy reasons that damages currency policy, lowers the efficiency of the specialized banks, and inhibits reform of the financial system.

Unlike the first category of investment, state directly regulated and controlled basic construction does not automatically improve as reform in other areas intensifies. For this reason, immediate efforts must be made and can be made to reform the mechanism for making long-term investment and issuing credit for policy reasons, both to solve currently extremely serious structural problems and to set the stage for reforms in other areas.

3) Basic tasks in reforming the mechanism for making long-term investment and issuing loans for policy reasons.

- Beginning to establish an investment decisionmaking and a risk restraint mechanism in which authority

and responsibility are linked, thoroughly changing the mechanism in which authority and responsibility is separate and government administrative agency interference is too great.

Establishment of a development bank. The basic function of a development bank is to make medium and long-term loans for investment in infrastructure, basic industries, new and developing main line industries, and regional development, granting preferential interest rates for some projects from which public benefit is appreciable, the period of return on investment is long, and economic returns are low. Development bank funds should not be regarded as equity investment.

Expansion of sources of funds for medium and long-term loans of a policy nature, soaking up funds available in society to enhance the central government's ability to guide investment activity and to readjust the structure.

The development bank should obtain most of its funds from the issuance of bonds. The government should set up a construction fund for the purchase of long-term, low interest, or interest-free bonds. The government should direct those postal savings and social security fund surpluses, and insurance payment surpluses must be used to buy regular interest rate development bank finance bonds. The government should also adopt appropriate policies to encourage financial institutions and individuals to buy development bank bonds. The development bank bonds that financial institutions hold should be useable as collateral for People's Bank loans. Guided by national macroeconomic plans and controlled by the scale of credit, the development bank should establish a credit evaluation system, a control system, and operating procedures in which control over the ratio between assets and liabilities and control over assets risks are linked.

5) Parallel Reform of Planning

The planning task is to achieve overall balance and to formulate industrial policy. Reform of the macroeconomic regulation and control system poses requirements for overall balance of a high order for planning. The make-up of industrial policy must also change. After market signals and interest relationship distortions are solved in the price, revenue, and fiscal systems, excessively tilted industrial policies should be discontinued, and frequent artificial interference with various market parameters should stop. Industrial policies are policies whose main function is to raise the quality of the entire economy. They are designed to improve the social and economic infrastructure, and to provide training in management, technology, and planning. In addition, export-oriented trade policies are adopted so that the structure of the domestic economy is improved in the course of fusing with the international economy. At the same time, strong emphasis is placed on the development of one or two leading industries, policies tilted appropriately in their favor to stimulate an upgrading of the industrial structure. One important way to bring industrial policies

to fruition is long-term financing for policy reasons. Planning units must now accelerate reforms in the following several regards:

- In the management of investment, as system reform intensifies, and the main investment entities' restraint mechanisms get stronger, planning units should reduce examination and approval of routine investment projects, gradually replacing the "examination and approval system" with a "declaration system." In the process of setting up a development bank, the planning sector should work together with the fiscal and banking sector to make parallel readjustments.

Plan quotas for state use of foreign exchange should be discontinued, a foreign exchange purchase system gradually replacing it.

Major reduction of various licensing systems to promote implementation of trade policies.

Making professional training an important part of the planning function.

4. The Different Roles of All Macroeconomic Regulation and Control Institutions in the Process of Building Socialist Market Economy Institutions.

First, fiscal institution reform is the most important task in building new institutions. It should be considered first in the building of institutions.

The fiscal system provides the basic framework for a market economy, and the revenue system is the main external requirement for enterprises microeconomic operation. Therefore, only on a foundation of normal fiscal institutions is it possible to begin to build a market economy in which competition is equal, resources are allocated effectively, and distributions are relatively fair.

Second, the urgency of financial institutions reform is manifested first in strengthening the macroeconomic regulation and control capabilities of the central bank to ensure economic stability. Financial institutions have two basic roles in a market economy. One is to regulate and control the currency supply through the central bank to ensure economic stability. Given the economic situation today, this reform should be accelerated. The second role is to provide completely developed financial institutions for economic activity to promote growth and improve returns. All financial market institutions will steadily develop and improve with the development of China's market economy. Therefore, reform and perfection of all financial institutions is a fairly long-range task.

Third, in an overall sense, reform of investment institutions cannot be accomplished within investment institutions. As reform of the enterprise system, and of fiscal and financial institutions progresses, and the functions of government agencies change, transformation of investment institution will be fairly easily accomplished. However, credit institutions that provide long-term credit for policy reasons must and can be founded with

all possible speed, both to help solve glaring structural problems in the economy today, and to set the stage for reforms in other regards.

The foregoing analysis does not mean that these reforms can be conducted independent of each other. The functions of individual institutions may vary; nevertheless, overall coordination is necessary in the process of promoting reform.

5. Reform the State-Owned Assets Control System, Building a State-Owned Enterprise Equity Structure in Which the State Holds Shares Indirectly, and Public Legal Entities Control Shares Directly.

1. Basic Reform of State-Owned Enterprises Must Begin With Reform of the Enterprise Equity System.

Since the advent of reform and opening to the outside world, China has adopted a series of enterprise reform measures that have produced definite results. State-owned enterprises have greatly changed the way they operate. Nevertheless, it must be realized that no fundamental change has occurred in the situation in which the equity rights of state-owned enterprises are ill-defined, government administration is not separated from enterprise management, rights and responsibilities are not clear-cut, the enterprise mechanism does not work smoothly, vitality is lacking, and returns are poor.

There are two steadily growing tendencies that should be watched very closely. One is that large amounts of state-owned assets are being lost in various open and hidden ways. State-owned assets have become most important sources from which small groups, individuals, and overseas investors obtain sudden riches. This loss of assets is a very unfair form of wealth redistribution that can easily lead to social instability. Second, state-owned enterprises' consumption of their capital, technical stagnation, and lack of reserve strength for development will seriously impair the structural improvement of the entire national economy, and international competitiveness. This is because China's energy, raw and processed materials, and heavy chemical industries, and key industries that provide machinery are still the mainstay state-owned large and medium size enterprises. Looked at from this angle, the ability to turn the present tide in state-owned enterprises has a bearing on the basic strength and the long-range development prospects for China's economy.

Therefore, enterprise reform must explore new approaches. It cannot tinker with the existing management system as it stands, nor can it simply continue to take actions that delegate authority and grant concessions.

2. The Nub of State-Owned Assets Administrative System Reform Lies in Rebuilding the State-Owned Enterprise Equity Structure, the Main Objects of Reform Being State-Owned Large and Medium Size Enterprises.

1) Two basic principles must be followed in rebuilding the state-owned enterprise equity structure.

First is the principle of clear-cut equity rights and the separation of government administration and enterprise management. The establishment of corporations in which the state holds shares to form rational legal entity organs, and the use of share control and share participation as a means of separating the ownership of all state-owned enterprises from government at all levels can serve as a means for building a new ownership structure that demolishes direct government interference in the operation of state-owned enterprises.

Second, is the principle of demolishing trade monopolies and the splintering of equity. In founding state-owned share controlling corporations that hold shares in state-owned enterprises, new trade monopolies must be guarded against. In the traditional system, administrative monopolies existed whereby government agencies monopolized all major enterprise decisions. If we simply convert existing government agencies in charge into industrial corporations that manage and administer the state-owned assets in an industry, we will wind up in a new industrial monopoly situation that will distort market signals and enterprise behavior, and lower the efficiency of the market economy. The harm will be no less than that of the administrative monopoly in the traditional system. Thus, the juridical entity control structure of new state-owned enterprises must be carefully planned with overlapping shareholding, and the spreading of equity to prevent a single state holding corporation from monopolizing an industry.

2) The focus of reform is transformation of the equity structure of state-owned large- and medium-sized enterprises.

Most medium and small state-owned enterprises are found among common industries and in tertiary industries. In a socialist market economy, there is no need for these enterprises to be state-owned. Furthermore, their method of operation suggests that these enterprises can fairly easily redefine their equity relationships through leasing, mergers, joint ventures and sale to become market entities responsible for their own operating decisions and for their own profits and losses.

The difficulty in reforming the ownership rights of state-owned enterprises lies in how to build an equity structure that is in keeping with the needs of a market economy without changing the public ownership character of large- and medium-sized state-owned enterprises. The fact is that China's state-owned large- and medium-sized enterprises hold a dominant position in both infrastructure and among basic industries, as well as in the leading sectors of the national economy. These sectors are both technology and capital intensive. They also have a pronounced economies of scale effect and pose substantial investment risks. They have a bearing on the national economy and the people's livelihood. This is not an investment area suited to private capital.

State enterprises will have to continue to play a major role in these sectors in the future. Therefore, the finding of a new state-owned enterprise form for state-owned enterprises in this realm has become a problem requiring urgent solution.

3. Theoretical Basis and Basic Objectives for Building a State-Owned Enterprise Equity Structure.

Basic economic theories maintain that independent ownership rights form the basis for operation of a market economy. The number of state-owned assets administrative system reform is thus the building of a public ownership system in which ownership rights [or equity] are independent.

The development of modern joint-stock companies and other juridical entity-controlled organizations have greatly enriched equity concepts. They have given rise to equity structures in which ultimate ownership and derivative ownership rights, control rights, and operating rights are separated from each other, and are mutually restrictive. Operating rights are held by enterprise management teams who are responsible for enterprises' day-to-day operation and decisions. Control rights are exercised by a board of directors. These rights include the appointment and payment of compensation to management teams, and decisions about the enterprise's main development strategies. Ownership rights belong to enterprise legal entities. The enterprise may mortgage or lease all property that the enterprise owns to meet debt obligations, and it is responsible for its own profits and losses. Ownership rights are held by shareholders as a whole. Their rights include rights to profits, and the examination and approval by shareholders meetings of strategic decisions that the board of directors make. By so-called independent equity is meant the separate, independent, and mutually restrictive relationship among the foregoing four rights.

On the basis of basic economic theory related to practice in reform of China's enterprises, and experiences with state-owned assets control abroad, we believe that the basic goal of assets administration system reform should be the building of a new state-owned equity structure. Broadly speaking, this includes the following four levels.

First, ultimate ownership of state-owned assets is in the hands of the state.

Second, the state (i.e., the agency that the NPC Standing Committee has empowered) is to employ all assets, control of shares, and exercise of share rights to control the equity (state directly held shares) of the national level holding corporations.

Third, in its status as an independent legal entity, the state holding company holds state-owned enterprise equity rights (legal entity direct share control) by controlling shares or exercising share rights.

Fourth, as independent legal entities, enterprises actually hold state-owned assets, the enterprise manager holding day-to-day operating decision authority.

Such a structure in which the state holds shares indirectly and legal entities hold shares directly does not change the dominant position of the public ownership system as far as ultimate ownership rights are concerned. However, it does enable a separation between the state's assets control function and operating function. The establishment of a mechanism in which ownership rights, control rights, possession rights, and operating rights are mutually restricted may produce a genuine separation of government administration and enterprise management that enables state-owned enterprises to become market entities that make their own operating decisions, and are responsible for their own profits and losses.

4. Ideas About the Specific Structure of State-Owned Indirect Shareholding, Publicly Owned Juridical Entity Direct (or Overlapping) Shareholding Plans.

First, the members of the Public Ownership Committee that the NPC Standing Committee established are selected by the NPC Standing Committee. The Public Ownership Committee serves as the ultimate personal representative of state-owned assets, or what might be termed a board of directors for the final reporting of all state-owned assets. The Public Ownership Committee has authority to pick members of the board of directors of state holding companies on the basis of the special powers it possesses and the holding company's performance. The work of the Committee is subject to the supervision of the NPC Standing Committee and the electorate.

Second is the establishment of several national level holding companies. During the period when national level holding companies are being founded, the Public Ownership Committee may allocate to holding companies a portion of state-owned assets, or give each holding company a substantial amount of equity distribution certificates for use in purchasing state-owned assets. This will serve as a Public Ownership Committee investment in the national level holding companies. The Public Ownership Committee will own the national level holding companies either because it is the sole investor or because it holds a controlling number of shares. It will appoint the members of the board of directors of the national level holding companies.

There are two ways to go about establishing national level holding companies in order to demolish industrial monopolies and pluralize equity rights. The first method is to establish a national level industrial holding company in each sector at the very outset, administratively allocating one-third of the equity of state-owned enterprises in that industry to the industry's national level holding company, and setting a limit on the percentage of sales of shares within the industry in which it directly controls enterprise shares. The remaining two-thirds of

equity in the enterprise is apportioned to other national level industry holding companies. The second method is to establish several comprehensive national level holding companies, the Public Ownership Committee giving each holding companies a sufficient number of equity distribution certificates, setting a limit on the percentage of control in any given industry, and allowing holding companies to choose freely for purchase equity in state-owned enterprises in different industry. This method would require making all state-owned enterprises stock holding enterprises in order to work.

Third, national level holding companies as independent juridical entities can use their control of shares or the exercise of their share rights to have or to get state-owned enterprise equity rights as independent company judicial entities.

Simultaneous with holding companies exchanging their equity holdings in state-owned enterprises, each enterprise also has a certain percentage of equity that can be held by various other juridical entities or private individuals, thereby forming a multiplicity of enterprise equity rights helpful to the building of a competitive corporate structure.

5. Several Main Tasks in Bringing About a Transformation of the Equity Structure of State-Owned Enterprises.

1) Conversion of existing state-owned large- and medium-sized enterprises to shareholding. The first requirement for putting state-owned enterprises on a shareholding system is an appraisal of the fixed assets and capital to determine the amount and value of enterprise assets, then translating enterprise assets into equity capital and dividing it up into shares, simultaneously designating the enterprise a legal corporate entity. Only in this way can national holding companies buy equity rights to control shares or exercise share rights. In addition, they can openly obtain shares, thereby taking in the share capital of other juridical persons and private individuals.

2) Choice of method for establishing national level holding companies. Generally speaking, national level holding companies may be either newly founded or existing state-owned banks, insurance companies, funds, and investment corporations may be converted into holding companies. Several different choices exist in the actual founding process:

One idea is to prohibit banking institutions from holding shares. This is because even though the source of funds for bank shareholding is not savings, these funds come from the administrative apportionment of equity rights or come from equity rights distribution certificates. However, if capital cannot be recovered from investment in shareholding, considerable risk still exists. Should a fairly large number of participating enterprises experience a crisis, this would shake bank stability. Thus, it is recommended that national level holding companies should be set up by assigning people from the former Ministry of Industry. However, in order to guard against

industrial monopolies, most of the equity in enterprises formerly under Ministry of Industry jurisdiction should be dispersed to other holding companies. Another idea is for all national level holding companies to become financial institutions. In actual practice, most state-owned enterprises in China owe large debts to banks. Bank holding of shares could be accomplished by trading liabilities for share equity. This would both solve the debt problems of enterprises and also make banks shareholders. Furthermore, the relationship between most large corporations and their subsidiaries is mostly one of financial control. The holding of shares by banks would help the development of large entrepreneurial blocs with banks at their center. We believe both methods might be blended.

3) Founding of secondary national holding companies. Large and medium size enterprises under control of the central government in China number more than 1,000, and large- and medium-sized enterprises nationwide number several thousand. The founding of just 10-odd primary level national holding companies would make the rebuilding of the state-owned enterprise ownership system difficult. Thus, secondary national holding companies must be set up. Primary level holding companies may exchange equity rights with secondary holding companies, and secondary holding companies may exchange shares among themselves. In their holding of equity rights in enterprises, secondary holding companies would be like the existing conglomerates.

4) Choice of methods for the exchange of shares held by state-owned holding companies and enterprises. One method is the pyramid ownership structure. This means a shareholding relationship in which exchanges are only downward and laterally. Such a system means that the holding companies at the top of the pyramid have substantial authority and control ability, and when secondary national holding companies are at the top of the pyramid, a fairly large number of large entrepreneurial blocs can be formed. By controlling shares, the state can wield enormous economic power. Another method is the network ownership structure in which shareholdings can be exchanged not only laterally, but vertically as well. The only pre-condition is that the national holding company's—particularly a secondary holding company's—equity rights be fairly decentralized. Enterprises may also hold equity rights in national holding companies. In Japan, the exchange of shareholdings by juridical persons is of this kind. We believe that a rather suitable method is to use the first method primarily at the outset, later on gradually relaxing controls on the exchange of shareholdings to move in the direction of the second method. Adoption of this transitional method includes one supposition and that is that at the outside the full state capitalization method of national holding company equity rights be adopted. Later on, depending on the distribution of holding company equity rights by different industries and different fields, a gradual shift can be made toward mostly national shareholding and exercise of share rights if distribution is mostly in ordinary industries and tertiary industries.

(5) Parallel Reform of Government Agencies

The establishment of national holding companies, and the separation of enterprises from direct government control requires corresponding reform of government agencies at the same time for future transformation of government functions.

Virtually all departments in charge of industry should be abolished. The industrial planning and management functions in the departments in charge can be made a part of the Economic Relations and Foreign Trade Committee in simplified form. The Economic Relations and Foreign Trade Committee should perform a function similar to that of the Japanese Ministry of International Trade and Industry [MITI]. As a transitional form, it would retain administrative agencies in a reduced form for basic industries and sophisticated strategic industries such as energy, communications, space navigation, and civil aviation.

Establishment of a large three-in-one fiscal, revenue, and national assets government financial system. The Ministry of Finance should abolish offices in charge of enterprises' financial matters, reforming the existing system of direct control over state-owned enterprises' financial affairs, and changing to an indirect control system in which the income tax, and supervision of returns on state-owned assets are the main components. The corresponding fiscal budget should be changed to a three account budget for regular expenses, construction, and capital.

The basic function of the State Administration of State Property is administrative supervision of state-owned assets, to protect the rights and interests of enterprises as legal entities against infringement, and to make evaluations and coordinate.

Establishment of an NPC Standing Committee-originated Public Ownership Committee as a supreme board of directors for state-owned assets. Not only would this committee appoint members of the board of directors of national level holding companies, but would also decide national investment, confer authority and retract authority.

6) Establishment of a legal entity equity rights flow and transfer mechanism to create market competition for equity rights among publicly owned legal entities and with other legal entities.

In order to do this, once state-owned enterprises have become shareholding enterprises, more shareholding limited liability corporations will have to be established, their shares listed for trading in the market when conditions are in being. At the same time, it will be necessary to establish and develop legal entity equity rights exchange organs, and to increase the number of securities exchanges in a gradual expansion of the number of legal entity shares listed. This will promote the flow and transfer of legal entity equity rights to bring about an optimum allocation of resources.

Publicly owned legal entity equity rights exchanges must also include secondary national holding companies for whom a percentage of equity rights trading may be set, fluctuations in the share trading price becoming important indicators for appraising shareholding companies. At the same time, this will more greatly stimulate holding companies, which will promote competition.

7) Transformation of the local state-owned enterprise equity system. If some or all local state-owned enterprises are redesignated a part of local public ownership, or if the NPC Standing Committee empowers local people congresses to set up local public ownership committees to serve as plenipotentiaries for local state-owned assets, local national equity rights organizations can be rebuilt using the methods described earlier. This will accelerate the transformation process throughout the country.

However, it is also necessary to consider the establishment of an ownership rights relationship for the exchange of share holdings between the central government and between one local jurisdiction and another, setting minimum amounts that may be sold to enhance the effective allocation of key resources within markets throughout the country.

6. Procedures and Steps for Transformation of the State-Owned Enterprise Ownership Rights Structure.

The first step is a general inventory of the assets and capital of state-owned (large- and medium-sized) enterprises must be conducted to accelerate and widen the transformation to a share system. This means translating enterprise assets into equity capital terms, dividing up the equity capital into shares, and determining the corporate status of enterprises as legal entities.

The second step is the establishment of a national level (bi-level) holding company, selecting existing banks, insurance companies, funds, and investment companies for transformation.

The third step is reform of government agencies, stock share companies simultaneously dividing up equity rights, exchanging share holdings, and developing open share acquisition.

The fourth step is listing the shares of share corporations where conditions exist for this, and developing equity rights trading in securities markets to promote the optimum allocation of state-owned equity rights.

Reform of the state-owned assets control system is an enormous piece of systems engineering that involves quarter. Careful planning and long preparations are needed. Therefore, we should get started as soon as possible on exploring experiences and promoting their spread. One fairly safe way of going about this is to select several government departments, and one or two cities as pilot projects. This will help summarize experiences gained through practice, revise and improve, and reduce the shock to society.

Analysis of Current Economy, Regulation

94CE0107A Hong Kong CHING CHI TAO PAO
[ECONOMIC REPORTER] in Chinese No 38,
27 Sep 93 pp 3-7

[Article by Huang Zhiling, associate researcher at the Economic Research Center under the State Planning Commission: "Analysis of the Characteristics of the Functioning of the Chinese Economy and the Effects of Macroeconomic Regulation and Control in the Present Period"]

[Text] In 1993 the Chinese economy is growing at an increasingly high rate; both economic results and problems in development are rather prominent. Objectively understanding the course taken and correctly evaluating the actual effects of the macroeconomic policy are of practical significance to the healthy development of the Chinese economy in the next stage.

A Review of the Economic Situation in the First Half of the Year and the Characteristics of the Functioning of the Economy

1. *The rapid growth in the national economy fully embodied the characteristics of an economy of a speed-efficiency type.* In January-June gross domestic product increased by 13.9 percent over the same period last year; the gross value of industrial output increased by 25.1 percent, with the growth rate for June exceeding 30 percent. While the economy grew rapidly, economic efficiency also improved rapidly. The comprehensive index of industrial economic efficiency reached 96.4 percent, an increase of 13.8 percent over the same period last year; the proportion of loss-making industrial enterprises fell from 20.4 percent in the same period last year to 18.2 percent.

2. *The nominal value of aggregate social demand increased rapidly, but the rate of growth in demand for physical goods, calculated on the basis of comparable prices, was relatively low.* In January-June fixed-asset investment across the entire society increased by 61 percent over the same period last year. But, because of the tail-wagging factor with regard to investment's growth rate and the factor of rapid growth in prices of investment goods, the amount of fixed-asset investment completed in terms of the amount of physical work completed stayed at a level of growth similar to that for the same period last year. In January-June consumer demand increased by 21.6 percent; however, after being adjusted for inflation, the rate was only around 10 percent in real terms. Thus, the rate of growth in aggregate social demand and the rate of growth in aggregate social supply calculated on the basis of comparable prices are, on the whole, basically in line with each other.

3. *The nominal inflation rate reached the second-stage level, but the situation was different in nature from the situation in the mid-1980s; the level was normal and acceptable.* In January-June the national index of cost of

living for the population grew by 12.5 percent over the same period last year; in this respect, the cost of living index for 35 large- and medium-sized cities grew by 17.4 percent. Also, the amount of money in circulation on the market (cash) increased by 54.1 percent over the same period last year. An analysis based on traditional methods would describe the inflation situation as severe in the first half of the year. But a more profound analysis will show that while the nominal inflation rate was high, the actual inflationary pressure was not as heavy as superficial figures would suggest. First, the price reform steps taken were large. Over 90 percent of consumer prices and 85 percent of prices for means of production were decontrolled; meanwhile, prices set by the state underwent large adjustments. Thus, the rise in the overall price level was caused partially by market-based price adjustments and the movement of nominal prices toward real prices. Second, cash supply increased quickly; but in terms of broadly defined money, M1 and M2 increased by only 34.2 percent and 26.5 percent respectively over the same period last year. Furthermore, most of the newly added cash was turned into enterprises' or other economic entities' circulating funds; that is, there occurred the new phenomenon of "turning cash into circulating funds." Third, the supplies of goods were rather abundant on the domestic market. In the first half of the year the Domestic Trade Ministry ranked 731 products on the basis of their supply and demand situations. In the cases of most products, supply and demand were in equilibrium or supply was larger than demand. Only around 10 percent of the products were in short supply, representing a decline of 1.3 percentage points. At the same time, domestic enterprises greatly shortened the time needed for making available additional supplies of goods in short supply on the market, and the duration of the cycle was reduced from several years in the past to several months, or even a few dozen days in the case of some goods. Fourth, amid rapid economic growth, the urban residents' income also increased rapidly. In January-June, after being adjusted for inflation, the rate of growth in the urban residents' per capita living-expense income was 13.5 percent in real terms; after being adjusted for inflation, the rate of growth in the peasants' per capita cash income was 7 percent in real terms. All this greatly alleviated inflationary pressures.

4. *The macroeconomic environment was increasingly being characterized by a tight situation; this was mainly caused by structural dislocations in relation to supply and by investment and financial disorders.* First, there were potential problems in regard to the stability of the agricultural base. Although the output of summer grain increased over last year, the problem of declining enthusiasm of peasants for growing grain remained unresolved. The concrete embodiment was the decline in sales of means of agricultural production in terms of physical goods. Second, some important means of industrial production and building materials were in short supply, and the bottleneck-constraint effects produced by the transportation situation on economic growth

increased. At the same time, substantial amounts of resources and production capacities were in an idle state. Third, investment activities were in a disorderly situation. The investment structure was irrational; there was a loss of control over the matter of development zones; real estate investment grew at an abnormal rate; the number of newly started projects increased rapidly; the capital construction front was too long; and macroeconomic returns on investment declined. Fourth, financial relationships were in disorder. In the first half of the year a total of around 100 billion yuan was raised through various means. Driven by self-interest, the banking system not only bypassed the control over the credit scale on an internal basis through short-term financing arrangements among banks, but also escaped the control over the credit scale on an external basis through transferring deposits and having subsidiaries carry out investments. The phenomenon of separation of the movement of social credit funds from the central bank's macroeconomic regulation and control was very serious. Fifth, the state's fiscal difficulties became even more serious: fiscal revenue losses totalled about 100 billion yuan, while fiscal expenditures increased substantially. In January-June fiscal revenues increased by only 1.4 percent over the same period last year, but fiscal expenditures increased by 12.1 percent.

In our view, the overall situation regarding the Chinese economy since early 1992, especially in the first half of 1993 which was characterized by rapid economic growth, has been good. It has not only met the speed requirements of the economic takeoff period, but also been generally in line with the aggregated resource-supply capabilities. The problem relating to the aggregate balance situation is far smaller than the problem caused by structural dislocations and disorderly phenomena in the economy. Also, economic growth has mainly been propelled by the continuous process of establishing the system of market economy, but not mainly by demand as is usually argued. The new situations and problems in the functioning of the economy are obviously typical of a period of system transformation. Some have been caused by the lagging behind of reform and some are inevitable in a period of transition.

The Macroeconomic Policy Effects of the Emergency Measures and New Problems

Since June, based on judgments on the economic situation in the first half of the year, the CPC Central Committee and the State Council have formulated and gradually adopted a series of policy measures to enhance macroeconomic regulation and control and to rectify investment and financial orders. After those policy measures of an emergency nature were adopted, there have been corresponding changes in various aspects of social and economic life, and some positive results have been achieved.

First, the situation of financial disorder has been rectified in a preliminary manner, and the financial situation is getting better. First, the momentum of vicious expansion

of activities of gathering funds in society in nonstandardized ways has been suppressed. The publicized handling of the "case of the Changcheng Corporation's illegal fund raising" has not only produced deterring effects on other people who raise funds in illegal ways, but also enhanced ordinary people's sense of financial risk. Second, substantial results have been achieved in cleaning up banks' regulation-violating activities of providing short-term financing: by 15 August over 70 billion yuan used for short-term financing had been recovered, accounting for around one-third of the funds used to provide short-term financing. In view of the fact that part of the short-term financing is in the category of banks' normal business operations, the situation on the market of short-term financing provided by banks to each other, which once became disorderly since early last year, has now been basically rectified and has returned to normal. Third, bank deposits have changed from decline into increase. People's savings deposits grew by 40.5 billion yuan in July, and by 36.2 billion yuan in August. July and August accounted for 38 percent of the 201.1-billion-yuan increase in savings deposits achieved in January-August. In addition, the situation regarding banks' net cash release is also improving: at the end of June the amount of money in circulation on the market was 486.36 billion yuan, an increase of 54.1 percent over the same period last year, but the amount of money in circulation on the market increased by only a little over 4 billion yuan in July-August, an increase much smaller than the increase in the same period last year.

Second, the growth in fixed-asset investment has slowed down, and normal investment order has begun to be restored. First, since early July the rate of growth in fixed-asset investment has declined. In August state-owned units' fixed-asset investments grew by 58.1 percent over the same period last year, representing an increase which was 10.4 percentage points smaller than the increase in July. Secondly, the number of newly started projects has reduced: August saw a decline of 1,428 projects from the same period last year. Thirdly, the rate of growth in investment in commercial housing has declined: the rate was 143.5 percent for January-June, and 135.1 percent for January-August. Fourthly, the development zone craze has cooled down: the number of development zones in the eight coastal provinces (or regions) has fallen from over 1,200 to over 200.

Third, There has been a change in the market situation: the market is declining amidst general stability. In August total social retail sales grew by 23.8 percent over the same period last year; the growth rate was lower than the rate of 28.4 percent for June and the rate of 26.5 percent for July. Prices for some means of production have begun to fall. On some important trading markets, prices for steel products have fallen by more than 10 percent, and the wholesale price for petroleum has fallen by around 10 percent, with the volume of trading declining substantially from the first half of the year. On stock markets, after falling below the high-price levels of 1,000 points and 300 points respectively, Shanghai

stocks and Shenzhen stocks have been fluctuating between 800 and 900 points and between 240 and 280 points respectively in the past several months. In the first half of the year, the foreign-exchange swap markets once saw a rate of 1 US dollar to 11 yuan renminbi; the rate has been hovering around the proper level of 1:8.8 for the past several months. Affected by the effective scale control and the central bank's withdrawal of credit funds, the credit market has also followed the general trend and is moving slowly. State banks' lending grew, in January-June, by 19.5 percent over the same period last year, but grew, in January-August, by only 15.9 percent over the same period last year; in this respect, circulating-fund lending grew by only 10.9 percent.

Fourth, the economy is no longer growing at an ultrahigh rate and the situation regarding fiscal revenues and expenditures is improving. After declining in July from June, the rate of growth for industrial enterprises at the township level or above nationwide fell, in August, by 1.7 percentage points from July. In January-August fiscal revenues and expenditures grew by 8.6 percent and 8.7 percent respectively; compared with January-June, the rate of growth in revenues was 7.2 percentage points higher, and the rate of growth in expenditures was 3.8 percentage points lower.

While fully recognizing the positive policy results of the emergency measures, it is also necessary to realize that the limitations produced by the short-term policy nature of the emergency measures have also created some new problems in practice which warrant great attention. On the one hand, the bursting of the bubble economy has also produced some impact on the real economy. The emergency measures adopted this time were designed to deal with the economic bubble produced by financial and investment disorders. Such policy objectives themselves do not have any problems. But, the expected results of the policy were overly idealized, as far as the effects of the bursting of the bubble on the real economy were concerned. In fact as banks have violently tightened the money situation in the past several months, basically most banks have been only getting repayments but not lending money, except for loans based on mandatory plans, while the door through which enterprises can gather funds from the market has been closely shut. As a result, enterprises are facing an increasingly tight situation regarding the circulation of funds. The phenomenon of "separation" of money from funds caused by cash payments and barter trading is very serious. The phenomenon of "triangle debts" which beset the Chinese economy in the past is spreading again. In July, nationwide, budgetary industrial enterprises' accounts receivable amounted to a net total of 173.4 billion yuan, an increase of 24.8 billion yuan over the same period last year. Since August the situation of being in arrears with debt payments has become even more serious. On the other hand, the focus of the emergency measures is on treating symptoms, while the construction of macroeconomic regulation and control mechanisms for a modern market economy, a task of a fundamental cure nature,

has been neglected. Exploiting the current overall situation characterized by the enhancement of macroeconomic regulation and control, some government agencies have adopted some recentralizing and direct-intervention measures and slowed down the transformation of their functions; some have even transformed their functions in an opposite direction. Therefore, the current improvement in the macroeconomic situation is only the temporary result of short-term administrative measures. Without accelerating reform on an overall basis, the traditional regulation and control methods are certain to violently collide with the laws of modern market economy; ultimately, it will be increasingly difficult to exercise macroeconomic regulation and control.

Therefore, the future policies to be selected should both enhance macroeconomic regulation and control and focus on improving macroeconomic regulation and control. First, the intensity of regulation and control should be controlled. Regulation and control must be carried out at appropriate times and be of appropriate intensity, so as to avoid damaging the economy's growth-related vigor. Second, while rectifying financial order, it is necessary to allow enterprises to gather funds from outside sources in some ways; it is necessary not to strangle both good and bad enterprises. Third, with regard to regulation and control means, it is necessary to reduce the use of administrative means as much as possible and increase the use of economic and legal means appropriate to a modern market economy. Fourth, it is necessary to accelerate the market-oriented reform of the system of macroeconomic regulation and control, especially efforts to reform such systems as the planning and investment systems, monetary and credit systems, fiscal and taxation systems, and distribution and social security systems. Mature reform plans should be adopted as soon as possible. It is necessary not to engage in endless discussion without making decisions, as such a practice will lead to missing reform opportunities.

FINANCE, BANKING

Financial Reforms Address Deficits, System Change
94CE01941 Beijing JINGJI RIBAO in Chinese 27
29 Oct 93

[Article by staff reporter Qian Fengxian "On Fiscal Reform"]

[27 Oct 93 p 1]

[Text] Deficit, the Special Advance-Warning Signal—On Fiscal Reform (I)

Editor's note: Reviewing the past helps us understand the present. Beginning today, this newspaper will publish a group of roundup articles which will review the 15 years of structural reform in the fiscal, financial, foreign trade

commerce, and other spheres for the purpose of demonstrating that accelerating the reform of the economic system and perfecting the system of socialist market economy as soon as possible are the only guarantee of the continued rapid and healthy development of our economy, and that there is no alternative. Today's article is the first one.

Perhaps because a deficit is recorded with red ink, it is often the special advance-warning signal indicating deeper-level fiscal problems, when one tries to understand the state's fiscal situation.

What is a deficit? Under our country's method of compiling the fiscal budget, debts (including domestic and external debts) are counted as budgetary revenues, when the total fiscal revenue, including debt revenues, is compared with the total fiscal expenditure, the excess of the expenditure over the revenue constitutes a deficit.

According to such statistical methods, our country's 1981 deficit was 2.55 billion yuan, except for 1985 which did not see a deficit, the deficit grew throughout the 1980s. The 1990 deficit was over 10 billion yuan, the 1991 deficit was more than 20 billion yuan, and the 1992 deficit was over 23.7 billion yuan. Our country's total deficit for 1979-1992 was 132 billion yuan. According to international calculation methods (counting debts also as part of deficit), our country's cumulative deficit would be over 422 billion yuan.

A deficit indicates that fiscal revenues are less than fiscal expenditures. The part of national income collected and distributed by the state is characterized by a situation of distributing and using more funds than should be the case.

In our country there are only two ways of resolving fiscal deficits: one is to use the previous year's fiscal surplus, and the second is to make overdrafts from banks or borrow from banks. For many years, deficits have only accumulated, while debt revenues have already been included in the budget, all this can only increase credit-balance pressure, thereby becoming a factor inducing inflation.

A deficit is not only a red warning signal indicating fiscal difficulties. It also admonishes people to pay attention to deeper-level problems in the functioning of the economy.

Since the start of the reform and opening up, the proportion of fiscal revenues to GNP has been on the decline all along, because of changes in the distribution situation. Domestic fiscal revenues amounted to 196.74 billion yuan in 1979, representing 26.7 percent of that year's GNP which was 399.81 billion yuan. The proportion fell to 21.5 percent in 1985, and to 16.6 percent in 1992.

At the same time, fiscal burdens have become heavier, instead of becoming lighter. In the 1990s the state

substantially raised the procurement prices for agricultural and sideline products several times, but the selling prices remained basically unchanged. The price differentials must be made up by state subsidies. Coal, petroleum, and other products of the basic industries as well as such agriculture-supporting products as chemical fertilizer and pesticide had also to be subsidized by the state's finance, because of the price distortions which could not be rectified in a short time. Throughout the 1980s the state appropriated a total of 26.3 billion yuan for price subsidies, if the part of enterprise-loss subsidies used for price subsidies was also included, then the total would be nearly 500 billion yuan.

Now subsidies have gradually changed from hidden subsidies into overt subsidies, but have remained a burden that the state's finance cannot totally get rid of. This year's price subsidy budget represents an increase of 15.9 percent over the actual disbursement figure for 1992, and the main part is used for grain and cotton price subsidies.

Since the start of the reform and opening up, the distribution relationships between the state and state-owned enterprises have been adjusted many times: the practices of partial profit retention, the practice of remitting taxes instead of profits, the system of independent responsibility for profits and losses of various forms have been adopted on different occasions. Each reform has had to be accompanied by some tax-reduction and gain-transferring measures, thereby continuously increasing enterprises' financial capabilities. In 1981-1990 the state added 420 billion yuan to the financial capabilities of state-run industrial and transport enterprises through tax-reduction and gain-transferring measures. When the 110 billion yuan recovered through new taxes instituted during the period and through the collection of "two levies" (for the fund for key energy and transport projects and the state fund for budget adjustment) is deducted, the net increase in enterprises' financial capabilities would amount to 310 billion yuan.

In order to manage well large and medium-sized state-owned industrial and transport enterprises, the state adopted five fiscal and tax policies in 1992 that is, increasing appreciation retention, increasing retention used as technological development funds, adding to circulating funds, having appreciation funds exempted from "two levies" obligations, and lowering the income tax rate for some enterprises. In 1992, because of those measures, enterprises' financial capabilities increased by 15.5 billion yuan, and fiscal revenues decreased by approximately 8 billion yuan.

The reasons for the fiscal difficulties and large increases in deficits have been, on the one hand, enterprises' low economic returns which have inhibited the steady growth of fiscal revenues, and, on the other hand, the excessively rapid growth in fiscal expenditures.

During the Seventh Five-Year Plan period, domestic fiscal revenues increased at an average annual rate of 8.7

percent; with domestic debt revenues deducted, the rate of increase would be 7.6 percent. During the same period fiscal expenditures increased by 9.9 percent each year, and the five-year cumulative excess of expenditures over revenues amounted to 46.07 billion yuan. Such growth in expenditures were mainly caused by the swelling of the bureaucracy, increases in personnel, and large increases in price subsidies and enterprise-loss subsidies, in addition to such normal factors contributing to expenditure growth as the state's key construction projects, education, science and technology, national defense, and support for agriculture. According to statistics, budgetary expenditures covered over 15 million personnel in 1979 and 28 million personnel in 1990, and covers over 30 million personnel at present, resulting in large increases in expenses on wages and other personnel expenses. Nationwide administrative management expenditures totalled 6.68 billion yuan in 1980, and 33.35 billion yuan in 1990; and the 1993 budget has had to appropriate 44.45 billion yuan for that purpose.

Furthermore, the state's financial capabilities are overly scattered, and revenues are lost in various ways; all this has also added to the serious fiscal difficulties. In recent years, many localities and organizations have set up funds under various names, which are not under the budgetary management, and large amounts of funds are circulating outside the system; and the phenomena of tax evasion, granting unauthorized tax-breaks, lax financial discipline, lax management, revenue losses, and wasteful expenditures are very serious.

It is said that "in the decade of reform nine years saw deficits." Surely, on the one hand this shows that the state's finance has made sacrifices for the sake of economic construction and the sake of people's lives. But on the other hand, the situation of fiscal capabilities also reflects in a concentrated way a situation where many are eating, while few are doing the farming. Such a situation cannot last.

The current deficit and fiscal difficulties have mainly been caused by the excessive demand for funds in the process of economic development and by the inappropriate distribution relationships found in the process of system transformation. In order to have sustained and steady economic development, it is absolutely imperative to start resolving the issue of fiscal deficits, especially the issue of chronic deficits.

[29 Oct 93 p 1]

[Text] The System, Affecting the Overall Distribution Situation--On Fiscal Reform (II)

In 1992 our country achieved many breakthroughs in deepening the reform of the fiscal system. That year not only saw the birth of our country's new enterprise accounting system, but also saw that the reform of the distribution system took a big step.

By analyzing that year, people would be more capable of understanding the drift of changes in the fiscal system in our country in recent years.

1. Multiple budget

In 1992 many people were surprised to see that in the fiscal sphere of our country the state budget, the central budget, and even some provincial-level budgets were compiled according to the "multiple budgetary" system.

Over the 40-plus years after the founding of the state, China all along used the single budgetary system, that is, including all fiscal revenues and expenditures of each year in a unified budget form. As there was no distinguishing between various fiscal revenues and expenditures based on their economic natures, and as "food money" and "construction money" were used together, such a system was unhelpful to analyzing budget implementation in terms of economic returns, to understanding the real causes of deficits, and to increasing the transparency in fiscal distributions.

The multiple budgetary system was created by the then finance minister of Denmark 66 years ago. Its basic content is to put budgetary revenues and expenditures in two or more revenue-expenditure budget forms on the basis of the different natures of the sources and uses involved, thereby producing the total state budget. The multiple budget currently used by our country is divided into two parts, the regular budget and the construction budget. If funds for regular expenses are not adequate, the scale of economic construction cannot be expanded at will; at the same time revenues from issuing treasury bonds and incurring external debts cannot be used for regular expenditures. In this way there will be constraints so that the growth in regular expenditures is in line with economic development. This will promote a situation where the amount of the state's expenditures on economic construction is determined on the basis of consideration of capabilities; that is, that objectives to be achieved are set in view of the amount of money available. People can easily see that the adoption of the multiple budgetary method was an important reform of our country's fiscal management system.

2. The separate taxation system

In 1992 the trial operation of the separate taxation system at selected places across the country was eye-catching.

Before 1980 our country's fiscal system was basically characterized by a situation of "unified collection and unified expending." In 1980-1984 the practice of "separating revenues and expenditures and multilevel contracting" was used. Since 1985 there has gradually emerged a situation regarding the distribution of financial capabilities, a situation which is characterized by the practice of "contracting" and which is based on the use of such methods as "revenue-increase contracting," "diving up the total amount," and "fixed subsidies."

The fiscal contract system has surely played a positive role in arousing the localities' enthusiasm and in making governments of various levels more responsible for financial management, but has also stimulated the localities' urge to pursue local and sectoral interests; and there have occurred such unhealthy tendencies as the tendencies to one-sidedly pursue local interests, to adopt the practice of "being large and having everything" and the practice of "being small and having everything," to carry out overlapping construction, and to practice regional economic blockade. It is common knowledge that nationwide there are well over 100 refrigerator production lines and well over 100 color television production lines. This makes it difficult to efficiently allocate and optimally use resources; as a result, it is also difficult to implement the state's macroeconomic regulation and control, and the economy of the society as a whole cannot produce a combined force.

The separate taxation system is a fiscal system which divides tax revenues and authorities between the center and the localities on the basis of having the respective parties control respective taxes, and is also the usual method currently used by Western countries to handle the relationships between the center and the localities. Since 1992 the trial operation of the separate taxation system has been carried out in Liaoning and eight other regions in China. Specifically, the content is: to make some taxes the fixed sources of central fiscal revenues while making some other taxes the fixed sources of local fiscal revenues, to make still other taxes the shared sources of revenues, set the expenditure base figures, and appropriately set the sums to be remitted by the localities and the sums to be given back by the center.

The separate taxation system has many characteristics: Under the system the major taxes which have a direct bearing on the value of output and on speed are made taxes shared by the center and the localities; this method can not only provide more balanced handling of the interests of the center and the localities, but can also weaken the localities' tendency to engage in blind development and to follow local protectionist policies; therefore, it is conducive to equal competition among enterprises. At the same time the separate taxation system also gives the localities the income tax which has a significant bearing on enterprises' economic returns. This will further heighten the enthusiasm on the part of local governments of various levels for economic development, for nurturing financial sources, and for carrying out fiscal management.

3. Having taxes and profits flow through different channels

If we say that the separate taxation system standardizes the distribution relationships between the center and the localities, then having taxes and profits flow through different channels is an action to standardize the distribution relationships between the state and enterprises. The trial implementation of this reform began in selected places across the country in 1988. The basic

content is: first, that the state, as the regulator of society, collects a 33 percent income tax from domestically funded enterprises, and then, in its position as the manager of state assets, participate in the distribution of state-owned enterprises' after-tax profits. At the same time, the "two levies" (for the energy and transport fund and the budget adjustment fund) will be gradually reduced and eliminated.

According to statistics, by the end of 1992, nationwide 34 provinces, municipalities, autonomous regions, and cities with separate plans as well as 20 central-level organizations implemented on a trial basis the method of having taxes and profits flow through different channels at selected places. More than 2500 enterprises served as trial points, including over 700 large- and medium-sized enterprises.

Having taxes and profits flow through different channels can facilitate the standardization and unification of the current taxation system, thereby providing various enterprises with an environment of equal competition. Therefore, experts concerned have pointed out that having taxes and profits flow through different channels is also a precondition for effectively transforming enterprises' operating mechanisms and for transforming the government's function.

Having taxes and profits flow through different channels can also overcome the contracting system's current problems of being prone to induce enterprises to engage in short-term behavior and of making people responsible for profits but not losses, so that the state and enterprises may share gains and risks, thereby making the distribution situation more proper and stable.

In essence, having taxes and profits flow through different channels, the separate taxation system, and other fiscal and tax reforms are all adjustments of the benefit-distribution relationships. According to Western scholars, as soon as two or more people are together, issue of benefit distribution will occur, and politics will be involved. The management of fiscal matters is the focal point of many distribution conflicts. It not only has a bearing on distribution—how to cut the "cake," but, more significantly, also has a bearing on how much enthusiasm people will have for making another "cake." The fiscal system involves the formation of a fair and standardized distribution mechanism, and is of special importance because any change in the fiscal system will affect the overall situation. Thus, carrying out timely reforms will be of profound and far-reaching significance to the deepening of the reform of the entire economic system and to the further emancipation of the productive forces.

Article Urges 'Properly Utilizing' Foreign Capital

94CE0072A Hong Kong NAN PEI CHH
[PERSPECTIVE] in Chinese No 9, 18 Sep 93 pp 37-39

[Article by Chu Xiaoping: "In Utilizing Foreign Capital, China Should Emphasize Leading Investment To Move in a Proper Direction"]

[Text] The key to attracting foreign capital and properly utilizing foreign capital lies in reforming the investment system; in order for Chinese enterprises to become investors with truly independent interests, property rights must be clearly defined; presently, it is necessary to further utilize the stock market in the effort to attract foreign capital, and to use the strategy of "exchanging market for technology" in an appropriate manner.

Since China's reform and opening up started in 1979, foreign direct investment has undoubtedly played an enormous positive role in China's economic development; at the same time it has also produced some negative impact. The main embodiment of this impact is the fact that foreign investment is not properly distributed among different industries. Since 1988 the situation where a great deal of foreign capital was invested in nonproductive projects has been changed to a great extent, and over the past year and more a growing number of infrastructure and basic industry projects have received foreign investment. Nevertheless, on the whole, the direction of foreign investment is still seriously flawed. As Mr. Rong Yiren has also pointed out, the distribution of foreign investment among the industries has not been adjusted in a satisfactory manner, and there are still too many manufacturing, nonproductive, and labor-intensive projects, but too few new technology projects which are also too small in scale. (See RENMIN RIBAO OVERSEAS EDITION 21 May 1993.) Many foreign-funded projects are of an "enclave" nature, and are not related to domestic industries and sectors. All this is unhelpful to alleviating the industrial structure problem in China and to promoting the adjustment of the industrial structure. Therefore, in utilizing foreign capital, China should not overly emphasize quantitative growth; instead, it should emphasize leading foreign investment to move in a proper direction, so that the introduced businesses can contribute to the adjustment of the domestic industrial structure.

The Core Issue Is Reforming the Investment System

In China, leading foreign investment to move in a proper direction is a very complicated and difficult issue, and involves factors in many spheres. When discussing this issue, people would mostly talk about adjusting policy and enhancing regulation. Such discussions are surely helpful. But, in the view of this author, the core issue remains reforming the investment system so as to make Chinese enterprises become investors which have truly independent interests, the independent right to invest, and the right to independently enjoy returns on investment, and which must also independently take investment risks.

Obviously, the foreign businesses which invest in China are all independent self-interested actors, and their property rights are clearly defined. But, the situation regarding the Chinese investors participating in joint ventures is rather complex. In general, there are three types: representatives of state assets; representatives of

mother-firm assets; and employees working for the Chinese side in joint ventures. Theoretically, the three groups of people should strive together to ensure investment returns on China's state assets, but in reality the three parties tend to have different interests and objectives. In addition, the property right relationships concerning the assets of the Chinese side are not clear, and no party is able to truly assume legally based responsibility for the investment risks involving the assets of the Chinese side. Consequently, a substantial number of Chinese-foreign joint ventures have become business entities which mainly pursue the interests of the foreign parties. Some joint ventures are jointly funded but not jointly managed, and have been completely contracted to foreign businesses. Some domestic enterprises are not forming joint ventures with foreign businesses in order to improve production technology and business management; instead, they are forming joint ventures in order to secure policy preferences and the right to engage in foreign trade. As laws, regulations, and policies are not well-developed, as the market is not fully developed, and as there are imperfections in the regulatory system, there exist many loopholes with regard to the functioning of the economy. Thus, this unique kind of self-interested actors, foreign-funded enterprises, can legitimately enjoy various preferential policies, and may at the same time also be overly eager to seek policy preferences as well as opportunities to gain benefits through exploiting all loopholes in existing imperfect policies, laws, and regulations. In particular, foreign businesses may become eager to create profits by using transfer prices through the internalization process. The external business environment does not provide accurate and realistic price signals for guiding foreign investment, and foreign-funded enterprises do not have interest-based urges to invest in the basic industries. Thus, it is very difficult to make enterprises with those interest-related characteristics respond properly and positively to the government's industrial policy.

Basic Conditions for Leading Investment To Move in a Proper Direction

As the analysis above shows, if the Chinese investors participating in joint ventures are not the real owners of assets and if there does not exist an economic environment which provides market-based guidance, then it is likely that decisions on investment in joint venture projects are not in accord with the overall interests and objectives of the national economy. The reason why the Chinese investors participating in joint ventures cannot become the real owners of assets is that there has not been substantial progress in the effort to reform the entire system governing property rights over state-owned enterprises. State-owned enterprises have not yet totally shaken off the status as administrative subordinates, and governments at various levels are still acting as investors of the Chinese side participating in joint ventures. Thus, in the process of utilizing foreign capital, not only is it difficult to harmonize interests of the Chinese side and the foreign side, but there are also conflicts between the

objectives of various self-interested actors on the Chinese side (such as the central government, local governments, and enterprises). In view of the analysis above, in directing foreign investment to the designated industries, it is necessary to have the following conditions in order to form effective interest-based inducement mechanisms and constraining mechanisms: 1) The property rights of Chinese investors are clearly defined. This will naturally minimize the phenomenon of being overly tilted in favor of foreign businesses in regard to the distribution of business gains in joint venture projects; only in this way would it be possible to make all the parties regard the joint ventures' overall interests as their business objectives. And, only in this way would it be possible to overcome the tendency to have investment and business behavior based on short-term interests. 2) Market-oriented economic reforms proceed smoothly; price signals on the market are basically realistic, and can thus play the role of guiding investment. 3) While the abovementioned developments are taking place, government's function should be fundamentally changed, so that it is no longer an investor, but the regulator, director, and umpire in economic and social activities. It carries out intervention in an appropriate manner only in cases of market failures. Foreign experience regarding direct investment shows: that only in a relatively free environment characterized by market-based guidance, would it be possible for individual economic decisions not to be seriously divorced from society's interests, and for host countries to reap the maximum gains from foreign direct investment.

The Main Steps That Should Be Taken Now

Acquiring the abovementioned three conditions will take a long time. One cannot make efforts to lead foreign investment to move in a proper direction only after the three conditions have been acquired and after interest-based inducement mechanisms and constraining mechanisms have been formed. In the present stage, it is still necessary to formulate the most appropriate possible policies and adopt special measures. In this regard this author will focus on two issues:

1. Further develop ways of utilizing the stock market in the effort to attract foreign capital. Over the past year and more, China has begun to utilize the stock market in the effort to attract foreign capital. This practice is now still in its experimental stage, and various policies, laws, and regulations as well as the relevant practical operations all urgently need to be further perfected. With the movement toward market economy, gathering foreign funds through issuing stocks will become an increasingly important way in which China utilizes foreign capital. On the one hand, this is in conformity to the new trends in international capital flow. On the other hand, getting foreign capital through the stock market is of special significance to changing the improper distribution of foreign investment among the industries in China. For, using the stock market makes it possible to turn the acquired foreign capital into long-term investment; once an investment is made, there can be no withdrawal. In

this way it is possible to change the situation where foreign investment and the related business behavior are based on short-term interests. In addition, in general listed companies in China are enterprises which enjoy good market prospects, high operational efficiency, and technological strengths. Obviously, directing foreign investment to those enterprises through the stock market is in accord with the industrial structure policy's principles of "revenue elasticity requirement" and "production growth requirement." Therefore, this approach is of great significance to the adjusting and upgrading of China's industrial structure.

2. Use the strategy of "exchanging market for technology" in a bold but appropriate manner. Generally, China's greatest location advantages regarding the utilization of foreign capital lie in: 1) abundant cheap labor resources; and 2) being the last huge potential market that still exists in the world. The former can only attract investments from small- and medium-sized enterprises, but the latter is a place where all kinds of foreign enterprises, especially large multinational corporations, are eager to enter. For many years the strategy of exchanging market for technology has all along failed to be used in a satisfactory manner. On the one hand, large market shares which should not have been given away have been given away; examples in this respect include large shares of the food, soft drinks, and daily-use consumer goods markets. On the other hand, shares of some markets which should have been given away have not been given away; as a result, investments made by large, world-famous multinational corporations remain very limited.

Appropriately using the strategy of "exchanging market for technology" is a very difficult and complicated job. Such is even more the case under the current situation in China where power has been delegated and scattered. A failure to do a good job of using this strategy can result in very substantial disruptive impact on domestic industry and the domestic market. According to some people, opening up the Chinese market can ultimately stimulate and improve national industry. However, presently, state-owned enterprises are going through a difficult period of transition, and there is still a lack of internal stimulating and constraining mechanisms in those enterprises, which are thus not competitive. When they fail in competition, huge burdens will be transferred onto the back of government or be directly shouldered by employees of the enterprises. A serious situation regarding this problem can cause social and political instability.

In following the strategy of exchanging market for technology, it is necessary to conduct overall planning on a nationwide basis, and apply differential policies to different industries and sectors:

1) Focus on giving away some domestic market with regard to the basic industries and bottleneck industries. China is planning to use the "BOT" method in the effort to attract foreign capital, so as to accelerate infrastructure construction, thereby resolving the "bottleneck"

problem in the development of the national economy. That is, in regard to infrastructure construction, foreign businesses can invest in certain big projects, or have certain big projects contracted to themselves. After being completed, during the 15-year contract period the relevant projects will be managed and run by the foreign businesses, and the Chinese side will collect taxes; after the expiration of the contract period, the entire projects will be returned to the Chinese side. Under this new policy, foreign capital can enter such spheres as those of power plants, railways, highways, ports, and postal services. The basic industries entail large investments, long payoff periods, and low profits. Consequently, it would not be possible to attract foreign capital without adopting special measures. Giving away some market can both satisfy foreign businesses' interest-related demands, and alleviate the "bottleneck" problem in domestic industry. As the domestic gap between supply and demand is too large in those industries, giving away some market shares will not produce excessively large disruptive impact on the domestic industrial sectors, but will on the contrary help alleviate the industrial structure problem at home.

2) With regard to the machinery and electronics industries, there should be a balance between giving away market and gaining export market; it is necessary to gradually increase the proportion of export market. In general, industries of the machinery and electronics sector are closely related to each other. Whether the various sectors of the national economy can achieve technological progress and growth in economic efficiency are, to a large extent, determined by the qualities, standards, and quantities of the technical equipments provided by the machinery and electronics industries; at the same time the machinery and electronics industries are important accumulation-generating and foreign exchange-earning industries. Therefore, introducing foreign-funded advanced technology projects into the machinery and electronics industries is of great significance. At present the main obstacle to the development of China's machinery and electronics industries is technological backwardness, and as a result it has been necessary to spend large sums of foreign exchange to import machinery and electronics each year. In 1992 the foreign exchange used by China for importing machinery and electronics totalled \$34.89 billion, representing an increase of 37.9 percent over the year before and a historical record and accounting for 43.3 percent of the total volume of imports for the country as a whole; trade deficit amounted to \$15.34 billion. The amount of foreign exchange used for importing machinery and electronics has been persistently high, and is getting even higher. Thus, giving away some domestic market is conducive to getting high-quality foreign capital. China's machinery and electronics sector is rather complete, and the number of enterprises is large; the difficulty lies in technological backwardness. Therefore, adopting the method of forming joint ventures with foreign businesses so as to utilize foreign capital in a focused effort to renovate old enterprises should be an effective way to

accelerate the production of industrial investment goods, key equipments, and electronic components. As domestic enterprises can make full use of existing plants and equipments as well as such supporting facilities as those relating to water, electricity, and gas and have rather skilled management personnel, technical personnel, and workers in substantial quantities, forming joint ventures with foreign businesses will not only save on investment, but also lead to production operations expeditiously. But, as the machinery and electronics industries are leading industries, the market shares given to foreign businesses should be appropriate; otherwise, there will be large disruptive impact on national industry at home.

3) Most of the products of foreign-funded projects in the light and textile industries as well as industries producing daily-use consumer goods should be exported. Development should be mainly in the direction of upgrading products and developing new products. Currently, the penetration of products of such projects into the domestic market is excessive, resulting in large disruptive impact on the domestic industries producing the same products. Therefore, it is necessary to impose stringent restrictions on foreign-funded projects whose products are mainly domestically sold ordinary consumer goods, including food, soft drinks, cosmetics, clothing, footwear, and other manufactured daily-use goods.

4) It is proper to consider terminating policy preferences given to foreign-funded projects in the finance, real estate, trading, commercial retailing, consulting, and other sectors. As foreign businesses enjoy particularly great advantages relating to ownership rights in those spheres and can reap huge profits, it is generally difficult for domestic firms in the same sectors to compete with them. Thus, even no preferences are given, foreign businesses' interest in entering the sectors will not be weakened. Otherwise, there will be large negative impact on the development of domestic firms in the abovementioned sectors.

As for other industries, in all cases it is necessary to adopt policies which can accommodate the situation regarding China's industrial structure and the need for its adjustment, and the policies should be coordinated with the overall plan on adjusting the nationwide industrial structure.

Ten Issues on Specialized Bank Commercialization

94CE0192A Beijing CAIMAO JINGJI [FINANCE AND TRADE ECONOMICS] in Chinese No 10, 11 Oct 93 pp 32-34

[Article by Liu Hengbao (0491 1854 0202), affiliated with the Hongan County branch of the Agricultural Bank in Hubei Province; edited by Xie Wei (6200 5898): "Ten Controversial Issues in the Commercialization of Specialized Banks"]

[Text] According to theoretical analysis and results of investigation and study, we hold that the commercialization of specialized banks is facing the following major issues or conflicts.

1. The conflict between commercialization (referring to the commercialization of state-owned specialized banks, and similarly hereinafter) and the current capital management system. The commercialization of specialized banks means that banks, within the limits allowed by national policy, and through their own credit business actions, take profit maximization as their supreme operating objective. While this requires specialized banks to have a high level of autonomy and more deposits and loans, specialized banks are now directly responsible for state macroeconomic regulation and control tasks on one hand, partially undertaking the "economic cop" (such as cash control) function, while the central bank's capital control over specialized banks has not been truly converted to indirect regulation and control on the other. As far back as 1984, the central bank had reformed its capital control system for specialized banks, changing from the former directive planned management to a capital control system of uniform planning, graded management, real loans of real deposits, and mutual financing. While this system undoubtedly helped to expand autonomy of bank operation, its actual operations certainly did not genuinely achieve this, remaining in the directive management mode. The central bank assigns credit and cash balance plans directly to specialized banks on one hand, while practicing quota control of all specialized bank loan targets on the other. With capital but no plans, banks cannot lend surplus capital, only being able to deposit it in PBC accounts as excess reserves, leaving the profit goal unable to be realized in operations, while also making commercialization impossible.

2. The conflict between commercialization and policy-related service. Not being liable for policy-related services is a fundamental prerequisite for commercial banks. Overseas experience shows that concentrating policy-related and business services in a single bank is bound to put banks in a double bind, leaving them to either emphasize their own profits at the expense of social benefits, or vice versa. So while commercial banks not being concurrently burdened with policy-related service has almost become an international banking practice, China's specialized banks are now all concurrently burdened with policy-related service, and in sizeable proportions at that. Taking the Agricultural Bank (AB) as an example, it now shoulders policy-related services, such as farm and sideline product purchasing loans, agricultural development loans, poverty discount loans, and advance-purchase downpayment loans, which account for nearly 50 percent of all AB loans, and as high as 70 percent in some areas, particularly poverty-stricken mountainous areas, almost turning the AB into a quasi-policy bank. Policy loans are characterized by large investments, long terms, high risks, and low return rates, features that are obviously out of line with bank commercialization principles.

3. The conflict between commercialization and the conversion of local government functions. The commercialization of specialized banks means that banks must have full autonomy in capital investment orientation and amount, as well as independent liability for decision-making risks. While this means that the government sector must not interfere in bank credit business actions, the relative lag in the conversion of government functions, and the still deep-rooted "output-value political-merit stand," leave the government sector still widely practicing forceful interference in bank credit actions, with some government officials establishing political merit by emphasizing speed, blindly setting up shops and starting projects, forcing banks to extend credit support. Very little attention is paid to efficiency and, if banks refuse to make loans, the government sector denounces them on the grounds that they are not supporting local economic development. So out of a number of considerations, banks usually are forced to submit to local government interference. Banks still have very little autonomy in project evaluation and loan investment orientation and amount decisions, which directly hampers their conversion to commercial banks.

4. The conflict between commercialization and lagging property-rights system reform. As commercial banks are corporations, they must have clear property rights (equity) limits, on which basis they are liable for operating risks and civil responsibilities. But as China's specialized banks are state-run financial enterprises, they are just like other state enterprises, in that they have a single equity subject, and are subject to the problem of blurred property rights relations. When there are no clear limits on which bank capital actually belongs to the state, collectives, or individuals, the relations among the inter-related rights and responsibilities cannot be accurately delimited. Even as to state capital or what is called the whole people's capital, all issues, such as who represents, owns, and holds, or how to maintain state capital ensured value and proliferation, have not been resolved well. So until our property rights system has been thoroughly reformed, pushing forward with the commercialization of specialized banks would be bound to alienate commercial bank actions, with state property being steadily gobbled up, which would naturally violate the original intent of the commercialization of state specialized banks.

5. The conflict between commercialization and our incomplete money market development. Special-bank commercialization would be bound to require banks to determine their own capital-maintenance form based on their differing capital sources, with long-term liabilities corresponding to long-term assets, and short-term debts matched to short-term capital, in order to maintain the liquidity of their overall assets. When clients make withdrawals, banks immediately go to markets to sell short-term assets to recoup their money in order to meet client needs. Maintenance of assets liquidity requires a

sound secondary securities-circulation market to provide circulation service for securities assets. While commercial banks generally maintain assets liquidity, particularly of short-term assets, mainly by orienting short-term liabilities toward purchases of treasury bills and short-term bonds or enterprise bonds, China has no short-term or enterprise bond markets, with treasury bill terms from three to 10 years, and essentially no one to three month short term-treasury bills as in Western countries. Moreover, while some banks hold bonds, they have no circulation arena, as bond circulation is concentrated mostly in cities. So bank short-term liabilities are converted either to loans or excess reserves, with all such capital distribution quite obviously running contrary to the features of commercial bank behavior.

6. The conflict between commercialization and our declining enterprise economic efficiency. Once special banks are commercialized, interest rates will become market oriented, with high capital inflow and outflow, so that banks will no longer grant losing loans. In this way, the overall capital interest-rate level will rise sharply. While bank loan targets are mainly enterprises, with enterprise economic efficiency determining their capacity to sustain interest rates, China's current situation is that about 80 percent of enterprise capital comes from bank loans, with one-third of our enterprises sustaining clear losses, yet another third sustaining covert losses, and only one-third making profits. The most recent data also show that one-half of the "three kinds of foreign trade" enterprises throughout China are also sustaining losses. Our enterprise capital structure and such declining efficiency mean that our enterprises cannot sustain high interest rates. While our current real interest rates (corrected for inflation) are far lower than nominal ones, some enterprises still complain about them being too high and unsustainable. So unless our enterprise economic efficiency improves sharply, special-bank commercialization will be mere idle talk.

7. The conflict between commercialization and the lag in the building of legal institutions. While commercial banks operate mainly according to laws, with their rational operating actions similarly needing legal safeguards to ensure that legitimate rights and interests in bank operations are not infringed upon, as well as illegal actions also needing to be severely cracked down on according to law, we still have no fundamental "Banking Law" in effect. With no legal bodyguards, there is no legal arbitration when the legitimate rights and interests of commercialized banks are infringed upon, making it impossible for them to be effectively protected.

8. The conflict between commercialization and declining bank-employee quality. Once specialized banks are commercialized, they acquire not only expanded operating authority, but also correspondingly increased economic liability. They must then make their own lending decisions, as well as accepting economic liability. Their lending will change from the current control mode in which lending is delimited by trades and ownership to one in which it is controlled by the length of lending

terms and the amount of risk. This means that certain past traditionally effective methods and measures will fail under the new conditions. Meanwhile, commercialized banks are independently liable for operating liabilities and risks, meaning that decisions on every project must be accurate and scientific, for higher lending security, liquidity, and profitability. This means that bank employees will need to fully understand conditions, being equipped with the capabilities to analyze, judge, project, and prevent lending risks. Quite obviously, the mode of thinking, management experience, and personnel quality evolved under our current planned-economy system are unsuited to a conversion to commercial banks.

9. The conflict between commercialization and the large percentage of tied up capital reserves. When commercial banks institute credit business activities, the impact of various internal and external factors forms a conflict between hard liabilities and soft assets. Large amounts of bank capital being invested in enterprises forms idle capital and bad loans. As banks have long calculated and withheld very little amounts each year for bad-loan reserve funds and cancellation after verification of bad loans (with the calculation and withholding percentage for bad-loan reserve funds having been increased only in the last half of 1992), the year's set aside bad-loan reserve funds do not offset the year's bad loans. Such tied up capital accumulates year after year, for an ever-growing historical burden, with tied up capital in some cases making up over 30 percent of all loans. So before specialized banks are converted to commercial ones, unless they deal properly with this historically-evolved tied up capital, it will be bound to affect their commercialization process. While they may be forced to commercialize, they will then be operating at overload capacity, making it very hard for them to be vital and undertake loss liability.

10. The conflict between commercialization and international commercial banking. As the recovery of our GATT seat approaches and the "Basel Accord" is applied, China's financial business will have to get on track with international finance, meaning that it will be faced with a stiff challenge from overseas commercial banks. The Basel Accord stipulated that the commercial bank risk-capital rate must reach 8 percent before the end of 1992. Overseas commercial banks set aside no less than 6 percent for bad-loan reserve funds, while all of the profits earned by China's specialized banks are paid into central revenue, leaving China with almost the world's lowest percentage of set aside bad-loan reserve funds. As the percentage truly used each year to supplement their own capital is extremely limited, our banks have very little capability to withstand various risks. So once we recover our GATT seat, and overseas commercial banks can set up branches in China, our banks will find themselves poorly matched with foreign banks, which will have an enormous impact on China's commercial-bank development and perfection.

As the conversion of specialized banks to commercial ones is the inevitable choice in the establishment of a socialist market economy, we need to absolutely unswervingly push forward in this area. As to the conflicts and problems that arise in the reform process, we similarly need to resolve them through intensification of reform. Particular steps should be taken mainly in the following areas:

1. We need to create a good climate for the conversion of specialized banks to commercial ones. The conversion of specialized to commercial banks will be impossible without a good external climate, which should include: A) We need to reform our current central bank quota control of specialized bank loan scale, to practice assets-liability-ratio management, with central bank regulation and control of specialized banks being converted thoroughly to indirect methods, i.e., to using the "three magic weapons" for particular regulation and control. B) We need to suitably increase the floating interest rate jurisdiction of specialized banks, to practice a flexible interest rate system. C) We need to separate out policy-related services, by establishing a policy bank to specialize in them. While this suggestion was made by some experts years ago, the current crucial matter is to put its particular operation onto our agenda. D) We need to convert government functions, so that governments no longer interfere directly in bank credit actions. Whether banks lend to local projects and how much they lend should be redecided based mainly on the results of their own evaluations, instead of being decided by government officials, with government functions being mostly coordination, oversight, and service, not direct manipulation of economic operations. E) We need to conscientiously implement the "Regulations on Converting the Enterprise Operating Forces of State-Owned Industrial Enterprises" promulgated by the State Council in 1992 and the "four-deregulations" reform of state commerce, in an attempt to improve enterprise economic efficiency. F) We need to develop legal institutions faster.

2. Specialized banks need to spruce up their own "internal skills" to meet the challenge, by actively searching for commercial-bank-conversion breakthroughs, and converting on their own initiative. In their commercialization process, specialized banks must bring their own dynamic roles into full play, in order to lay a good conversion foundation. A) They need to develop better staffs, by improving employee proficiency. They need to widely institute commercial bank theory and practice studies among their employees, in order to create a talent corps suited to commercial bank operations, which will be the key to converting specialized to commercial banks. B) They need to practice assets-risk management, by setting differing targets for bank capital, estimating risks, and taking varying control steps based on amount of risk, in order to lower risk and raise efficiency. C) They need to strive to organize their capital to eliminate overload, and work to raise their efficiency to rid themselves of bad-debt capital. D) They need to establish scientific, standardized, and democratic credit-decisionmaking procedures, in order to keep their

lending accurate in orientation and efficient, and avoid new bad debts. E) They need to reform their internal structures and operating-network establishments, by adjusting their current structures and establishing new ones suited to fundamental commercial-bank principles.

3. We need to push forward actively with property-rights system-reform. As current studies show that the shareholding system is the best form of realization for enterprise property rights, it would be entirely possible to reorganize our existing specialized banks into shareholding banks, to upgrade them into genuine enterprise corporations.

4. We need to vigorously cultivate a secondary securities market, by increasing short-term bond-issue limits and volume, in order to find a way out for commercial bank short-term debt, provide a basis of application for the operation of open market services by the central bank, and pave the way for the central bank to convert to indirect regulation and control.

RMB Convertibility, Foreign Exchange Control Reform

94CE0054A Chongqing GAIGE [REFORM] in Chinese No 5, 20 Sep 93 pp 98-105

[Article by Guo Shuqing (6753 2885 3237): "On RMB Convertibility and Foreign-Exchange Control System-Reform"]

[Text] China's current foreign-exchange control system has reached the point where there is a pressing need for substantive reform. While continued delay would be particularly adverse to maintenance of domestic macroeconomic stability, expanded attraction of foreign investment, and adjustment of our international payments structure, reform will mean seizing the crux of the matter, by clarifying related policy-climate needs, and by drawing up detailed plans that are realistic and feasible.

1. The Major Flaws in the Current System

Our 1992 balance of international payments and domestic foreign exchange supply and demand have fully exposed the defects of the current system. According to international experience and the general fundamentals of international economics, it is impossible to acquire an understanding of China's conditions.

Customs data [for 1992] show a foreign trade surplus of over \$4 billion, as well as a nontrade surplus of over \$4 billion, and a record utilized foreign investment (capital inflow) of nearly \$20 billion, but a repayment with interest of only a little over \$13 billion. According to this data, China should absolutely not have experienced a drop in cash on hand and a sharp rise in our market exchange rate.

An accounting by the State Foreign Exchange Control Bureau (FECB) based on statistical specifications of our [1992] balance of international payments shows our

trade account with a surplus of \$5.18 billion and, in our nontrade balance, receipts of \$3.95 billion for tourism alone, up 39.1 percent from 1991, and a direct domestic and foreign investment in our capital account of \$11.16 billion, up 155 percent from 1991, similarly meaning that we should not have seen a foreign-exchange shortage.

Even based on China's "state foreign-exchange balance" sheet, this situation should not have occurred. Not including items, such as foreign trade by "the three kinds of foreign trade" [joint-venture] enterprises, "three imports with one compensation," and "cultivating exports with imports," our trade receipts [for 1992] were \$43.386 billion, with expenditures of \$50.447 billion, for a deficit of \$7.061 billion. Our nontrade balance showed a surplus of \$6.324 billion, with our foreign borrowing for 1992 up \$8.76 billion, also meaning a surplus.

So what is the source of the problem? The problem lies in our 1992 capital account, with a countable capital outflow of \$30.48 billion, in addition to an error loss (actually also a capital outflow) of \$8.42 billion, so that despite our capital inflow of \$30.22 billion, we still had a high net capital outflow of around \$10 billion. It is precisely this fact that has the international experts and academics feeling so puzzled. For a developing country, as a capital shortage is the greatest development problem, the general aim should be to strive for a net capital inflow, so that foreign resources can be used to speed up domestic investment in construction, meaning that trade should see a corresponding deficit. But our net capital outflow with a trade surplus means exactly the opposite: that some of China's economic resources are being used abroad. In another area, while the consensus is that all countries that control foreign exchange proceed from the two objectives of preventing 1) excessive imports of manufactured products, particularly consumer goods; and 2) capital outflow (or capital flight), China's foreign exchange control seems not very effective in these two areas, particularly in the second, where there is almost no control at all. Of our 1992 capital outflow, over \$10 billion was repayment of foreign-country investment loans, up to \$10 billion was various forms of foreign export credits (mainly commercial loans), up to \$10 billion more was direct overseas investment, and the remaining over \$10 billion was financial investment (including short-term funds moved to savings abroad). This situation was caused certainly not by any individual or departmental responsibility, but rather by the system, which we will analyze later.

In addition to three consecutive years of net capital outflow, our current system has also created other negative consequences, mainly as follows:

1) Severe chaos in our domestic foreign-exchange market. China's current foreign-exchange control system actually artificially divides foreign exchange up into the three chunks of a) state-controlled parity-price foreign exchange b) conversion-market negotiated-price foreign exchange and c) black-market free-price foreign

exchange. This parallel "three-track" order is bound to create much friction and loopholes, abetting various profiteering activities, infringing on the legitimate rights and interests of the state, enterprises, and individuals, and making it possible for a minority to acquire exorbitant nonoperating profits.

2. Sustained damage to RMB prestige. As we allow domestic residents and enterprises to hold foreign exchange, give tacit consent to the reality that certain areas bring in and circulate foreign currency, and have long not taken effective steps to ban the foreign-exchange black market, RMB prestige is severely damaged. Data from the Hong Kong and Shanghai Banking Corp show over 14 billion yuan in HK dollars in domestic circulation, or nearly 30 percent of all HK dollars in circulation. Foreign currency coming into and circulating in China is equivalent to us paying a currency-issue tax, which is a veritable outflow of valuable funds. Moreover, it also fosters a blind public faith in foreign currency. A particularly glaring problem is that while our longstanding foreign-exchange-RMB is legally equal in value to that of ordinary RMB, it is not actually equal in value.

3. Sharp exchange-rate volatility on conversion and black markets. Exchange rates on conversion and black markets essentially do not reflect the price relations between tradable products and services, being influenced rather by many incidental factors. Their sharp volatility and extreme instability severely interfere with our attraction of foreign investment, the foreign trade of domestic enterprises, and our domestic prices. In 1992, while China's average export-conversion cost grew very little, our conversion and black-market exchange rates rose about 50 percent.

4. Suspicion and reproach in international society. In light of China's sustained growth of foreign-trade exports and the large flow of foreign investment into China, international society believes that China's currency should not continue to be devalued. So when our conversion-market exchange rates rose sharply in 1992, certain developed countries criticized us for officially manipulated devaluation actions, in order to offset the pressures on open domestic markets created by eased foreign-trade control and lowered customs tariffs. This was of course certainly not the case.

5. State foreign exchange reserves being more in name than in reality. China's currently defined national foreign exchange reserves, or state cash on hand, is certainly not foreign exchange completely bought off by the central bank, but rather foreign exchange under centralized state control after exchange settlement at listed-price exchange rates by export-earning enterprises. About one-half of it is an enterprise and local "quota." Under normal conditions, enterprises and localities can at any time buy back this "quota" for making overseas payments, or sell this priority-use right to other enterprises on the conversion market. Even all of the foreign-exchange quota turned over to the center is certainly not

all reserves, as some of its goes to meet central foreign-exchange expenditure deadlines. This method is quite different from the international one in common use by most countries.

6. Reduced foreign-exchange control effectiveness. While quota-control requires a strict exchange-settlement system, irrational exchange rates and the great difficulty in buying foreign exchange is causing an increasingly severe exchange-evasion phenomenon, with enterprises actually having opened many cash accounts, and banks operating out of profit and competition motives to secretly help enterprises get around various control terms. The relative level of foreign exchange receipts from tourism is falling steadily. While each outside tourist to China provided \$144 in foreign-exchange receipts in 1978, this figure was down to \$104 by 1992. So the positive effects of control are declining steadily, while the negative ones are evergrowing.

II. Particular Factors Contributing to the Formation of the Current System and Lessons Learned From Its Experience

China's unique current foreign-exchange control system has gradually evolved out of our traditional highly centralized one through the steady adoption of piecemeal adjustment measures (mainly stopgap ones) to deal with new conditions and problems that have appeared since reform and opening.

In their conversion from command to market economies, most countries have adopted the following general methods: 1) They have adjusted their official exchange rates to basically reflect the scarcity of foreign-exchange resources, while banning the domestic circulation of foreign currencies and forbidding individual residents and enterprises to hold foreign exchange. 2) They have eased trade-account control, with banks providing the foreign exchange for importing in line with state industrial and trade policy. 3) Under terms for a certain export growth, they have eased control over other nontrade items in recurrent accounts, while practicing a strict examination and approval system for items that might indirectly cause capital outflow (such as still setting foreign-exchange purchase-quotas for those who go abroad as tourists). 4) Once their economic might has reached a certain level, they have gradually eased control of their capital account, permitting a certain amount of capital outflow. 5) Once their economies have become fully internationalized, with the final achievement of full convertibility between their own and foreign currencies, they have permitted enterprises and individuals to freely hold foreign-exchange cash and savings, while continuing to not allow domestic circulation of foreign currencies. This so-called full convertibility is certainly not absolutely free conversion. For instance, Japan still imposes certain restrictions. Tourists leaving that country may not take out more than 3 million yen, and investors leaving Japan still need to acquire government permits for amounts exceeding a certain figure. Such

restrictions are not necessarily due mainly to currency-stability considerations, but proceed also from ones, such as preventing money laundering and the occurrence of significant investment mistakes.

But ever since we began to reform, China has taken a unique route. First, we did not uniformly adjust our official exchange rate, but instead continued to retain an overvalued RMB list price, while practicing an internal settlement price for trade, leaving us with two official exchange rates with a price difference of nearly 100 percent. Then to support exports, we practiced a foreign-exchange retention system, allowing export-enterprise localities and departments to hold some of the foreign-exchange quota. In the mid-1980s, we consolidated our list price, while continuing to retain our foreign-exchange retention system. Then in line with enterprise demands, we set up a foreign-exchange-quota conversion market. So, we still have two legal exchange rates, or a "dual-track system" which, with the black market, makes a "three-track system." Meanwhile, we also acknowledged the legality of residents holding foreign exchange, allowing banks to attract residents' foreign-exchange savings, with withdrawals subject to restriction, thus forcing the easing to deposit and withdrawal freedom. Then we went on to allow "joint-venture" enterprises access to the foreign-exchange conversion market. As to our longstanding foreign-exchange black market, we took a laissez-faire approach, also not dealing conscientiously with the entry and circulation of foreign currencies in certain southern zones. During our period of improvement and rectification, we successively lowered the comparative price of RMB to foreign currencies, for a time bringing our list, negotiated, and black market prices very close to the point where they could almost be said to have been consolidated. Most recently, we have again taken several steps: we have allowed RMB within certain limits to freely enter and leave our borders (with the maximum per person per trip being 6,000 yuan); some provinces and cities have experimented with a cash-retention system; individuals can convert foreign exchange at market rates, with sales of foreign exchange not restricted, but purchases having quotas, which differs by region; and we have allowed individuals to buy and sell foreign exchange, including foreign-exchange futures, on the international foreign-exchange market through commissioned financial institutions.

Comparing China's unique method with the one generally used by most countries internationally shows the most basic difference to be that we have never adjusted our exchange rate to a price level that adequately reflects the degree of foreign-exchange scarcity, to consolidate the various exchange rates on our foreign-exchange markets. This situation is very similar to the "dual-track system" that we have long retained for capital goods prices. The departments and enterprises that enjoy low-priced foreign-exchange supplies oppose higher exchange rates, often being in the category of the so-called "of importance to the national economy and the people's

livelihood," while export-earning enterprises and departments demand higher exchange rates or increased subsidies, without which it will be hard for them to export more while costs are rising. A compromise method would be to retain unchanged or slightly higher rates for the former, while compensating the latter mainly through additional subsidies or granting the advantage of self-control over retained foreign exchange. This would be equivalent to providing subsidies to both parties, which would be two types of subsidies, one being government-allocated import-export subsidies, and the other the use of foreign exchange to grant more covert subsidies (for imports being low-priced foreign-exchange subsidies, and for exports being subsidies through allowing retained foreign exchange to be sold at high prices). In our 1991 foreign-trade reform and corresponding exchange-rate adjustment, we adjusted the retention percentage, solving one problem, i.e., eliminating fiscal subsidies to export enterprises, thus restricting the special preferences enjoyed by exports—except for credit policy, to the one item of retained foreign exchange. In fact, the problem could have been sharply simplified right from the start if we had devalued the RMB in one step to an adequate degree, so that export enterprises would not have needed such complex preferential policies, and the imports that the state needs to support and encourage could have been taken care of completely through fiscal subsidies, or through appropriate adjustment of domestic sales prices. As our domestic pricing system is out of order, we need to focus our efforts on setting varying contracted payment duties for various export sectors or products, in order to level the uneven playing field created by the exchange-conversion-cost gap.

As our list prices have always been obviously lower than those produced through a balance of supply and demand, Chinese residents have been unwilling to sell to banks the foreign exchange that they acquire through various means, while foreign tourists and enterprises that come to invest in China are bound to do all they can to seek out ways to exploit this difference. So even if we cracked down severely, the results would not necessarily be ideal, and we might cause a foreign-exchange outflow instead of an inflow. As our past mandated conversion of foreign exchange to RMB for overseas remittances left residents feeling that they had suffered a great loss, our overseas remittances began to fall sharply. Under such conditions, the only way to resolve this seemed to be to allow domestic residents and foreign-invested enterprises (FIEs) to hold foreign currencies, and to open and draw on foreign-exchange accounts in banks. Even though banks admittedly attracted large amounts of foreign-exchange deposits, they certainly did not buy out use rights, making it very hard for them to feel at ease about using them for domestic investment and credit, while keeping them on hand was even less profitable. So their only way out was to retransfer them out to international money-market operation for value-protection and appreciation to pay back deposit interest, which paved the inevitable way for capital outflow. But the matter does

not end here due to the existence of our foreign-exchange black market. As those who want to use foreign exchange domestically can convert RMB at black market rates, and other ordinary residents with a blind faith in foreign currencies can convert some of their savings into foreign-exchange deposits or cash, the amount of foreign exchange held by residents has increased sharply, now estimated to amount to more than \$20 billion. Only an insignificant percentage of this foreign exchange can be used for domestic construction, as it is steadily flowing back to international money markets.

There is another basic obstacle to the domestic use of the foreign-exchange deposits attracted at home and abroad and funds raised through other means by Chinese banks (mainly the Bank of China [BOC]). As domestic enterprises, particularly state-owned ones, are accustomed to eating out of banks' "big pots," with very weak credit restraints, banks are naturally very concerned about whether loans are repaid with interest on schedule. Moreover, as enterprises prefer money borrowed from foreign banks to foreign-exchange loans from Chinese banks, because it enjoys a series of foreign-investment policy preferences, as well as many nonpolicy preferences, enterprises with genuine repayment capability do not necessarily want loans from Chinese banks. And while the State Council has long provided in documents that BOC foreign-exchange loans are to be treated as foreign investment, it is very hard for the pertinent policies to be fully implemented. The only way that can well harmonize the interests of both parties is for domestic banks to win over a number of banks outside of our borders to organize bank-group loans, or to sell bonds on behalf of enterprises to raise funds on international money markets, so that sellers are also key buyers, and returns can become foreign investment. Other foreign-exchange funds could only be steadily transferred to overseas-bank deposits or used to buy overseas securities. Hong Kong and Shanghai Banking Corporation figures for 1992 show that the net liability in HK dollars of Hong Kong banks to domestic ones reached a high of \$42.4 billion HK, or over \$5 billion, accounting for 5.7 percent of the HK-dollar generalized currency M_1 . Of course, the sum of the funds returning to the United States, Japan, and Britain is even more enormous. BOC data alone for 1992 show an exchange position as high as \$25.56 billion (not including the foreign-exchange balance of \$15.3 billion as state custody), of which \$13.78 billion is in purchases of foreign securities.

In addition to financial means, the outflow of capital beyond our borders through direct investment is also sizeable. This involves certain particular factors: 1) The close relations of the Hong Kong and Macao region with Mainland China do not exist for other countries. Investment in the Hong Kong and Macao region by domestic enterprises is significant not only economically, but also politically. While it would be unrealistic to try to cut this off altogether, leaving it unchecked without restriction or guidance as at present is also adverse to the economic development of mainland China with Hong Kong and

Macao. Estimates for recent years are that the annual investment by mainland enterprises and government departments in the Hong Kong and Macao region has averaged over \$2 billion a year. 2) Due to the economic collapse and market shortages in surrounding countries, such as the former Soviet republics and Mongolia, domestic enterprises and individuals have also invested there to seize valuable product-sales opportunities. But a high percentage of this investment is in the form of in-kind products and equipment. 3) Due to the imbalance and uncoordination between the domestic economic system and politics, certain enterprises and individuals in coastal zones who want to expand their investments feel strongly that domestic transregional development is not as secure as overseas development, so invest the foreign exchange obtained through various means or funds acquired through settlement outside of our borders after exporting in developed nations, such as Europe, the United States, and Japan. 4) In order to acquire stable raw-materials supplies, domestic enterprises invest in overseas producing areas that are rich in raw materials to ensure the raw materials needed for expanded domestic production. While such investments are certainly not all irrational, the problem lies in our lack of effective control, with not even basic statistics on the resulting capital outflow, let alone any guidance or regulation and control.

Another phenomenon that has come to the attention of international financial institutions, such as the World Bank, is that many domestic enterprises and departments, in order to obtain the various policy and non-policy preferences enjoyed by FIEs, and enhance their investment security, have adopted the method of first exporting funds and then bringing them back into China in the form of foreign investment to engage in various development activities. Such funds are commonly called in China "fake foreign devils." There are still no precise figures on the ratio of such "fake foreign devils" to our overall use of foreign investment in 1992. While pertinent World Bank experts estimate that it is very high, this is still hard to prove. But regardless of how high the ratio of such circuitous funds is, it certainly does not affect the overall situation, with our capital outflow still far exceeding our capital inflow.

In summary, the peculiarity of China's current foreign-exchange control system is that while our official exchange rates remain irrational and nonuniform, and we have still not lifted our strict control over our general trade account, we do allow domestic residents and enterprises to hold foreign-exchange cash and deposits, and we have sharply eased our control over capital outflow, which is occurring on a large scale. So we undoubtedly cannot restart down the ordinary road of following international foreign-exchange liberalization, advancing step by step, but must accept reality, by adopting special countermeasures to make as fast a transition as possible to a more uniform and rational system pattern.

III. The Aims and Terms for Achieving RMB Convertibility

In a certain sense, the RMB is already convertible, in that if foreign exchange cannot be bought at list prices, it can be bought at negotiated prices and, if it cannot be bought at negotiated prices, it can be bought at black-market prices. Buying RMB with foreign exchange is even easier in that tourists outside of our borders can buy it at list prices, in fact also at market prices, not only within China's borders, but also outside, and can also bring it in legally. Due to the existence of "joint-venture" enterprises and the large number of Chinese-invested enterprises outside of our borders, overseas investors can actually also freely buy and sell RMB within certain limits.

Thus, to be more precise, the mission facing us is certainly not achieving RMB convertibility, but rather consolidating RMB-convertibility terms and limits, to make it a system that is more standard and subject to regulation and control.

The current situation is RMB convertibility achieved through the distorted form of the coexistence of "three tracks." Going further into the matter, our current convertibility also differs sharply in various regions within China, not only because our foreign-exchange conversion markets are in fact mutually isolated regional markets, but also because their restrictions on foreign-exchange transactions by enterprises, particularly individuals, also differ sharply. One particular difference we have with other countries is that our foreign-exchange markets are not genuine foreign-exchange markets, but rather foreign-exchange priority-use-rights markets (i.e. quotas), moreover not interbank markets, but rather ones to which enterprises have direct access. Another unusual feature worth particular notice is that the RMB is far more convertible outside our borders than in China.

In light of this, the specific aims of China's foreign-exchange system-reform to achieve RMB convertibility in a rational form can be set forth as follows:

1. To achieve a uniform exchange rate that can float freely within certain limits, while correspondingly banning the domestic circulation of foreign currencies, and suppressing all black-market transactions.
2. To abolish our foreign-exchange retention system, and establish an open, transparent, and nationally uniform foreign-exchange market. This will mean an interbank market, in which enterprises and individuals will buy and sell foreign exchange through banks, but not have direct access to the foreign-exchange market.
3. Based on controlling capital outflow, to reconstruct our foreign-exchange control system. The foreign-exchange control sector would no longer be charged with regulation and control of foreign trade, with import regulation being shifted entirely to tariffs and a few means, such as distribution quotas and licenses. We

should draw up foreign-investment policies varying by industry, country, and region, to encourage or restrict as desired.

4. Based on the current central foreign-exchange balance, the central bank should further buy in a certain amount of foreign exchange, to form rational state foreign-exchange reserves, with all other exchange for importing being bought on markets, and the import losses of a few commodities being subsidized at percentages set by the Ministry of Finance, which subsidies would be eventually eliminated with the further rationalization of our domestic pricing system.

What is the immediate feasibility of reforms to achieve these aims? In other words, are the required terms available? The following is a point-by-point analysis.

1. As to the real purchasing power of the RMB, we should be full of confidence. In certain surrounding economically depressed or backward countries and regions, the RMB is regarded as a hard currency with very high prestige. Even in economically developed Hong Kong, a clear contrast to the panic-buying of foreign exchange by mainland residents is the many Hongkongers lining up at banks to buy RMB. A basic fact is that the real purchasing power of 100 yuan of RMB in Mainland China is generally much higher than that of \$100 HK in Hong Kong. So using purchasing power as an evaluation yardstick, the RMB is even more qualified for a sustained rise in value (of course, the high domestic inflation rate might conceal this appreciation trend). In fact, the changes in the RMB market exchange rate from 1989 to 1991 show that the RMB has seen a period of appreciation and, as our scope of tradable products and services further expands, the RMB's position will be better consolidated. Certain overseas foreign-exchange speculators are now studying ways to buy and sell RMB, as they have seen the possibility of future relative appreciation of the RMB. On the other hand, we need to be more vigilant about this, as allowing overseas speculators access to our RMB foreign-exchange market might touch off sharper market volatility. In short, our government and central bank must have confidence in the RMB, by adopting policies that help to preserve instead of sap RMB prestige. Meanwhile, we need to actively propagandize and indoctrinate the public against blind faith in foreign currencies, and that buying foreign currencies for savings and investment is certainly not worthwhile in the long run, as the RMB interest rate far exceeds that of other currencies. While our rate of overall domestic price rises may continue to exceed that overseas, the steady appreciation trend of the RMB will offset such losses by a large margin.

2. As to our current domestic foreign-exchange reserves, progress in speeding up the consolidation of our foreign-exchange rates will not involve too great a risk. Our current state cash balance is \$20 billion, with a bank foreign-exchange balance of \$30 billion, and residents holding foreign-exchange cash of over \$10 billion, which all adds up to the huge amount of \$60 billion. When

India made the rupee partially convertible on 1 March 1992 and then fully convertible (under limited terms) on 1 March 1993, it had only \$5 billion in foreign-exchange reserves, a large part of which came from IMF borrowing and savings deposits attracted by foreign-exchange banks from nonpermanent Indian residents. When Indonesia made its currency convertible, it had only \$400 million in foreign-exchange reserves. And even earlier, when Japan achieved limited yen convertibility in the early 1950s, its foreign-exchange reserves amounted to only \$700 million.

3. As putting our exchange rates onto a single track will be bound to cause a rise, will this be sustainable by imports that currently depend on parity-price foreign exchange? It is estimated that the current subsidies to such imports amount to 20 billion yuan, of which one half are low-price foreign-exchange subsidies, and the other half are revenue-appropriation subsidies. Due to these dual high subsidies, the loss-waste and profit-erosion created by such imports is quite severe. If we take strict oversight steps, and eliminate covert exchange-rate subsidies, it is estimated that only a little over 10 billion yuan can take care of this. So this matter should no longer be an obstacle to the reform of our foreign-exchange system.

4. As to merging our exchange rates and eliminating quotas, while some export-earning enterprises will profit and others lose, there will be a basic balance. The loss for export enterprises will be that without retention quotas, the state will no longer hold back funds for them, so that if they want to retain foreign exchange, they will have to cut it out from their own RMB funds and, if they borrow it from banks, they will have to pay such heavy interest that it would not pay. While they will no longer enjoy the past profit from being able to wait for the right price to sell their quotas, they will also acquire obvious advantages: 1) Without a list price, exchange settlement can benefit from market exchange rates. 2) When mandatory payments are lifted, part of the advantages from equalitarianism and indiscriminate transfer of resources will revert to enterprises, in that they will be able to buy from banks at any time the foreign-exchange currencies needed for their regular foreign-trade activities. A problem that might exist is not a foreign-exchange system-reform one per se, but rather a related one. That is, should we simultaneously or slightly later eliminate our directive export-earnings plans? While doing so would be highly advantageous to improving the operating conditions of foreign-trade enterprises, as some sharp-loss business is done only because it is mandated by plans, it might have a negative impact on export volume, as the export turnover of state-owned foreign-trade enterprises might grow more slowly or decline slightly for a time. But to be objective about it, such volatility should not be seen as a bad thing.

While the above four related matters show that the basic terms do exist for accelerated foreign-exchange system-reform, these terms alone will not be adequate, meaning that we will still need to take the following necessary steps:

1. We will need to moderately tighten domestic credit, in order to prevent foreign-exchange supply shortages caused by too many RMB funds. Foreign-trade enterprises with more foreign-exchange quota balances that apply for increased RMB loans should be refused, and required to first sell off their quotas.
2. We will need to appropriately lower our domestic interest rates on foreign-exchange deposits, or collect a certain account-opening fee on new foreign-exchange accounts, in order to encourage the use of more RMB for savings and accumulation.
3. While we will need to adjust our tariff and trade policies by lowering nominal tariff rates, we will also have to inventory and reduce on a large scale all preferential policies by raising our real tariff rates, and striving within a year or two to raise our real tariff rates from their 1992 level of 4.6 percent to about 10 percent.

IV. Application-Plan Options for Foreign-Exchange Control System-Reform

While we have clarified our foreign-exchange system-reform aims, as well as the key related factors and the necessary external terms, how to set specific transition methods still requires detailed study. Particular application-plan options are subject to several restraints: 1) As our economy is much more internationally competitive, trade friction has arisen between certain developed countries and us. Under such conditions, if we continue to adopt the method of adjusting our foreign-exchange list price to close it up with market exchange rates, this is likely to provide the impression and a handle for others to say that "we are officially manipulating our exchange rate, by supporting dumping through RMB devaluation." 2) Eliminating in one step our list price to consolidate it with market prices would run into the problem of a sharp decline while market exchange rates were still not uniform or standardized, making it very hard for all parties to make appropriate adjustments. 3) As to theory and international experience, while China should not at present allow residents and enterprises to hold foreign exchange, as we have long since permitted individual residents to hold foreign-currency and foreign-exchange deposits, it would seem essentially unfeasible to cancel this permission. Even enterprise cash accounts are hard to control (enterprise foreign-exchange deposits in 1992 were up over \$6 billion, not only from "joint-venture" enterprises, but also in large amounts from ordinary ones). 4) Our already approved policy of allowing RMB to legally enter and leave our borders has provided a new key means of capital outflow. At 6,000 yuan per trip per person, and about 30 million trips in and out of our borders per year, the most RMB that could theoretically be taken out and then back in would reach a high of

nearly 100 billion yuan. Through this exchange, the foreign exchange that would have been brought into China would remain abroad. So as we now have only a little over \$10 billion in foreign exchange that has been genuinely brought out by the central bank, with the use rights for the rest of our state cash balance belonging to localities and enterprises, it seems that it would not be right to disavow these vested interests and incorporate them all to the state. We would at most deduct a percentage, with the rest of the quotas being handled by localities and enterprises themselves.

In light of these restraints, our recommended application plan could occur in several steps:

Step 1. Once we establish the external terms, such as an appropriate tightening of domestic credit, we should announce that we are changing foreign-exchange quota retention to cash retention (with no many experimentation by regions). Meanwhile, we should declare that our previous foreign-exchange quotas will remain valid for a set period (for instance, three months), after which they will automatically be abolished. Our foreign-exchange conversion market will naturally experience a state of increased supply with correspondingly decreased demand, so that exchange rates will begin to fall. Meanwhile, while we will allow all licensed banks access to the foreign-exchange conversion market or to trading in foreign-exchange conversion business, to open up foreign-exchange conversion markets in all places throughout the country, we will have to set upper and lower limits for bank exchange rates, to prevent exchange-rate transition volatility. We should in principle permit all foreign-exchange purchases for payments of recurrent accounts, with residents having the money allowed to buy foreign exchange of \$1-\$2/\$200 per person per trip with passport visas. While capital-account expenditures must be tightly controlled, those in line with national overseas investment policy should be approved.

Step 2. Once quota-validity terms expire and market exchange rates are roughly stabilized at a certain level, we should announce that we are abolishing our list prices, as well as our foreign-exchange retention system. We should take policy steps to encourage export enterprises to make exchange settlements on their own after generating foreign-exchange earnings. While some that do not or do so less should be treated separately, we should allow enterprises to keep cash income with the foreign-exchange control system regularly examining and approving enterprise earnings. Our foreign-exchange conversion-market business should be shifted to specialized banks, with the State FIC Bank taking part in specific foreign-exchange market operations and specialized banks setting exchange rates and conducting transactions under central-bank guidance. During this period, the central bank should buy a certain amount of cash when market exchange rates fall, on one hand to strengthen national foreign-exchange reserves, and on the other to regulate markets, stabilize exchange rates, and prevent transition falls. The central bank and FIC B

must not require specialized banks to shift or pay on the foreign exchange deposits that they attract.

Step 3. Once market rates approach the estimated rational exchange-rate level (probably about 7.5 RMB to the dollar), we should use policy means to regulate and stabilize, then fine-tune volatility based on our balance of international payments and domestic macroeconomic conditions, to establish a more mature floating exchange-rate system. When we abolish our parity-price foreign-exchange distribution system, all imports that need state subsidies should be subsidized through fiscal appropriations. We should abolish our directive export plans for foreign-trade enterprises, to eliminate inefficient exports, and enhance the capability of foreign-trade enterprises to adapt to the foreign-exchange market. We should continue to take policy steps to support RMB deposits, to curb the tendency of enterprises and individuals to hold excessive amounts of foreign exchange. We should improve our control over capital accounts. Once purchases of foreign exchange for rational uses can be satisfied at will, hoarding of foreign exchange will become a very irrational choice, which we should widely propagandize and indoctrinate against, so that the position of the RMB will steadily strengthen, and a key factor in our longstanding capital outflow will be eliminated.

While the above analysis and recommendations are preliminary, with many details needing deeper study, the basic assessment is probably unquestionable, so we hope that it will be paid attention to by the pertinent department leaders and colleagues. The time has come to speed up our foreign-exchange marketization. Unless the proper decisions are made, it is feared that there will be endless future troubles.

FOREIGN TRADE, INVESTMENT

Effects of GATT Entry on Foreign Trade

ACE0066A Beijing GUOJI MAOYI [INTERTRADE] in Chinese No 141, 15 Sep 93 pp 29-31

[Article by Chen Jiaqin (7115 1367 0530): "Effects of GATT Entry on Foreign Trade"]

[Text] The 1990's are a most critical decade for the achievement of the strategic objective of the second phase of China's socialist modernization. The development of foreign economic relations and trade will contribute enormously to the realization of that strategic objective. As economic structural reform continues to deepen apace and as China further opens up to the outside world, the process of resuming its membership in GATT is picking up steam and the entire national economy is developing into a socialist market economy. This article explores the impact of accession to GATT on China's foreign trade and examines what responses China should take.

I. Accession to GATT Presents Opportunities for China's Imports and Exports

It should be affirmed that after rejoining GATT China will enjoy a variety of rights by virtue of its membership, creating favorable conditions for its push to secure more benefits from and more opportunities for international trade. The benefits can be summed up as follows:

1) It will enjoy most-favored-nation treatment and be subject to fewer nontariff barriers. By checking protectionism, GATT will help boost Chinese exports and imports.

There have been seven rounds of tariff negotiations under GATT since 1948. As a result, the import tariffs imposed by nine developed nations on industrial finished goods have dropped from 40 percent to 4.7 percent. The lowering of import tariffs by developed nations presents opportunities for both China's exports and its imports. On the exports side, tariff reductions will not only provide an opportunity for it to expand the exports of its industrial manufactured goods, but will also help enhance the price-competitiveness of its exports. Moreover, there is reciprocity between member nations when it comes to tariff rates. This fact can help China select the markets with the most attractive prices for its export commodities as well as trading partners, thus creating the conditions for maximizing its economic returns. At present China has signed most-favored-nation bilateral agreements with over 100 nations and regions. Generally speaking, those bilateral agreements have a time limit, whereas most-favored-nation treatment under GATT is indefinite. After China rejoins GATT, it will enjoy preferential treatment in the form of tariff cuts, the fruits of eight rounds of negotiations under GATT, giving China's export drive a boost.

Taking aim at the rising tide of protectionism in international trade, the Tokyo Round and Uruguay Round of trade negotiations produced a number of agreements on reducing nontariff barriers, presenting another opportunity for China's export drive.

On the imports side, as China opens itself wider to the outside world and exports increase, Chinese imports are bound to grow in scale along with the demand for them. The elimination of tariff and nontariff barriers will help lower production costs and offset the raw materials shortages at home by boosting imports, including raw materials. On the other hand, by importing advanced foreign technology and equipment, we can bring about the optimal organization of elements of production and make Chinese exports more competitive. Typically primary products command low prices on the international market. With tariff and nontariff barriers coming down, the import prices of certain primary products will drop further. Because of the practice of subsidizing farm exports in certain countries, importing an appropriate amount of low-priced agricultural products like wheat while exporting high-priced grains, not wheat or rice, will not only save foreign exchange at the import end but will also help China realize a greater comparative advantage.

2) Anti-subsidy and anti-dumping measures may be used to counter unjustified anti-subsidy and anti-dumping charges. This will help Chinese exports.

Currently a country may rule unilaterally that China has violated its domestic discriminatory anti-dumping anti-subsidy legislation. After China rejoins GATT, however, a country that levels charges will be required to adhere to the "Anti-Subsidy Agreement" and "Anti-Dumping Agreement" soon to be adopted at the Uruguay Round of trade talks. Similarly, by invoking the appropriate anti-subsidy and anti-dumping provisions under GATT, China should impose an anti-subsidy tax and anti-dumping tax on products that are government-subsidized or dumped on the Chinese market at low prices by foreign companies. That way China can increase its exports and open up the international market.

3) The restoration of China's GATT membership will take foreign trade reform in China one step closer to international norms and reinvigorate its foreign trade.

Rejoining GATT means that China must adhere to international rules when it comes to foreign economic relations and trade. On the one hand, it must operate in accordance with the law of value and the principles of competition and supply and demand of the market economy. It must try to get maximum economic leverage out of tariffs, credit, exchange rates, and prices in the macro regulation and control of foreign economic relations and trade so that direct foreign trade management dependent mainly on administrative methods will give way to indirect management using mainly economic and legal tools. On the other hand, we must operate in accordance with the rules and regulations of GATT, improve our legal system, and speed up law-making. No time should be wasted in introducing China's "Foreign Trade Law," "Anti-Subsidy Law," and "Anti-Dumping Law" to transform the disorderly competition existing today into orderly competition and ensure the sustained, steady, and healthy expansion of Chinese exports.

2. Foreign Trade Challenges Posed by Accession to GATT

Now that we have affirmed the opportunities given China by the resumption of its membership in GATT, we must also be aware of the problems and challenges that we may encounter in implementing GATT. These are the main challenges:

1) China's industrial exports will face fierce competition on the international market.

No doubt the quality of China's export commodities has improved significantly after 14 years of reform and open policy, their global competitiveness much enhanced. However, we must also realize that on the whole Chinese export commodities still trail those of developed nations in terms of quality and are not competitive on the international market. Even the traditional labor-intensive textile and apparel industries will face stiff

competition from newly industrialized countries and developing nations. In the wake of scientific and technical advances and with the application of microelectronics technology, the nature of textile and apparel production has changed. No longer are textile products and garments purely labor-intensive industrial products but products that are both labor- and technology-intensive. Already China's textile and apparel exports are running into fierce competition from those in various countries in Southeast Asia.

According to studies and estimates by the departments involved on large- and medium-sized enterprises in China, just 51 percent of China's lineup of exports sell well on the international market and only 25 percent are truly competitive. Of the almost 60,000 newly developed products introduced each year, a mere 3.5 percent reach international standard. At present, China's export commodities are still dominated by merchandise at the middle or lower end of the market; upscale products with a high added value are few and far between. This is a major reason why Chinese export commodities are not competitive in the world. According to statistics compiled by the International Textile Manufacturers Federation, in 1989 a ton of assorted fiber products (including yarns, fabrics, knitwear, and garments) from Italy earned \$17,247 in foreign exchange, the highest in the world, followed by West Germany, \$15,625; Japan, \$13,711; France, \$12,598; Korea, \$9,483; Taiwan, \$8,724; and China, \$5,484. The foreign exchange earning capacity of China's fiber products was just one-third that of Italy and much lower than even that of Taiwan. All these facts constitute a grave threat to Chinese exports.

2) China's own technology-, capital-, and knowledge-intensive industries will face challenge from and must compete with foreign industrial manufactured goods that make their way into the Chinese market.

Regarding its technology-, capital-, and knowledge-intensive industries, China has traditionally followed a policy of import substitution, ignoring imports and over-emphasizing domestication. As a result, some of the technology-, capital-, and knowledge-intensive industries and products, including automobiles, electronic products, chemical industrial goods, and upscale textile products are not competitive on the world markets. Upon rejoining GATT, we will be required to cut tariffs, reduce administrative interference, and open up the domestic market. The domestic market will inevitably be hit hard by imports. According to estimates by the departments involved, industries that will be directly affected will account for one-third of the gross industrial output value. If we take into account the interconnections between industries, the impact will be very widespread. A Chinese-made sedan, for instance, costs between 40 and 100 percent more than a comparable or similar foreign product. Then there is a host of supplementary fees and taxes, such as the special consumption tax, lateral coordinating fee, and vehicle purchase fee, further distorting the market prices of Chinese-made sedans. For these reasons, China's automobile industry

faces a stiff challenge from imports. With China giving market access to foreign imports and cutting tariffs, chemical industrial raw materials will also take a hit from a variety of low-priced good-quality imports. Also facing ferocious competition from newly industrialized countries and developing nations are China's textile and apparel exports. Thus the challenge we are confronting is a severe one.

3) With the adoption of intellectual property rights in the pharmaceutical industry, agricultural chemical industry, and tools industry, China will face a grave challenge from similar overseas products.

The pharmaceutical industry and agricultural chemical industry are major importers and exporters in China. The intellectual property rights agreement concluded during the Uruguay Round extends patent protection to the production of drugs, agricultural chemical products, and equipment, thereby constituting a grave challenge to China as an exporter and importer of these products. Since the PRC was founded in 1949, China's pharmaceutical industry has so far produced a total of over 3,000 drugs, including those now in use, about 99 percent of which are imitations. Of the 783 Western drugs in production in 1990, 97.4 percent were imitations and only 20 were researched and developed in China itself. After the intellectual property rights agreement goes into effect, China's pharmaceutical industry could no longer go on imitating, so in this sense the agreement is a serious challenge to China's Western drug exports. Also, of the 146 varieties of pesticides in production in China today, the imitation rate is a high 95 percent. Of the 3,600 kinds of fine industrial chemicals in production in China, 97 percent are imitations or belong to the low end of the market. In accordance with the spirit of the memorandum on United States-Chinese intellectual property rights negotiations, pre-1985 patented products are excluded from administrative protection and will gradually be eliminated in the wake of scientific advances. To produce or imitate new varieties patented after 1986, one must pay steep royalties and patent purchasing fees. The alternative is to spend a huge amount of foreign exchange to import pesticides.

On the other hand, if we go the domestication route, research and develop the products mentioned above, we will run into all sorts of constraints—technology, the caliber of qualified personnel, financial resources, and the time needed to develop a product. Thus what is involved is a process of development, not something that can be achieved any time soon.

3. Grasp the Opportunities, Welcome the Challenges, and Accelerate Foreign Trade Development

To adapt to the changes on the foreign trade front after China becomes a member of GATT, we must update our thinking; speed up the transformation of the enterprise operating mechanism; carefully modify our laws, regulations, and policies; regulate, control, and manage foreign trade on a macro level using economic tools, so on and so

forth. The idea is to strike a balance between securing the rights due us under GATT and fulfilling our obligations. Accordingly, the following ideas and measures are proposed:

1) To make Chinese exports more internationally competitive, it is essential that we liberate our thinking, update our ideas, transform the operating mechanism of foreign trade enterprises and large and mid-sized industrial enterprises without delay, and orient ourselves to the international market.

Conditioned by the planned economy, China's foreign trade companies and large- and medium-sized industrial enterprises have traditionally been the implementors of the state plan and are used to operating monopolistically. "What is produced determines what is available on the market." Herein lies the core of the problems that have been holding back China's foreign trade development. These days foreign trade procurement prices in China have been rising endlessly, yet selling prices on the international market have been in a slump, with the prices of certain primary products actually falling. Foreign trade companies find it hard to do business. Among the large and mid-sized industrial enterprises, many are operating at a loss. To cut tariffs and abolish import/export permit management under these circumstances will open the gate to a flood of foreign imports and deal a heavy blow to domestic industries. This is a widespread concern among foreign trade enterprises and large- and medium-sized industrial enterprises after China rejoins GATT.

How do we handle these challenges? In my opinion, the global market is an integral whole. Opening up to the outside world and engaging in international economic cooperation and competition are the "megatrend" in history. All countries, including China, must participate in international specialization, international exchange, and international competition, and introduce the mechanism of market competition when they reach a certain point in the development of social productive forces. Our own socialist market economy must be integrated into the world market. The leaders of all foreign trade enterprises and large- and medium-sized industrial enterprises must liberate their thinking, update their ideas, and take the initiative to rid themselves of such obsolete concepts as "monopoly," "the market must take whatever is produced," and "the enterprise is the implementor of the state plan." They must make enterprises more competition-minded and efficiency-conscious and have the courage to participate in competition, taking on the international market boldly. They should not rely on administrative protection by the state but must seek survival and development by rapidly transforming their operating mechanism and through competition. During the transitional period provided for developing nations under GATT, therefore, we must boldly utilize foreign funds, resources, and intelligence and import advanced foreign technology and equipment; trade market for technology; work extra hard to attract large multinational corporations to invest in China; and import the

raw materials and high-tech products of which there is a dire shortage at home. We must introduce advanced scientific management and scientific organizational methods from overseas to remake our enterprises, adjust the mix of export industries and the mix of export commodities, and organize production scientifically in accordance with international standards and those of the importing nations. We must overhaul our sales and marketing organizations and channels based on the sales and marketing characteristics of the international market so as to meet their objective requirements. Only thus can we spur China's large and mid-sized enterprises to adjust their industrial structure; improve their technology; raise their product quality, making them more upscale and increasing their added value; enhance their economies of scale; lower their production costs, and increase their profits, thus making their products more competitive on a ferociously competitive international market.

2) No time must be wasted in harmonizing China's foreign trade operating mechanism with the norms of international trade.

Based on the theory of the socialist market economy, the characteristics of competition between monopolistic corporations on the international market, as well as the rules of international trade and China's special national conditions, we must continue to deepen foreign trade reform in China and go the corporate route. Specifically this is the model we should follow:

One, set up shareholding enterprise groups that combine trade with industry, trade with agriculture, or trade with technology. Besides buying and selling the handful of state-run commodities, this kind of foreign trade enterprise groups, where trade should play the dominant role, should transcend operational boundaries and diversify their operations even as they concentrate on a particular line of business or product and go the industrial and international route. Otherwise, they would have difficulties achieving accountability for their own profits and losses and making themselves more internationally competitive. In view of China's vast territory, we should primarily model our foreign trade enterprise groups on the conglomerate-like large enterprise groups in Japan and Korea, without, however, excluding medium-sized or small enterprises. The localities, for instance, may organize medium-sized enterprise groups. Collective enterprises and private enterprises too may put together small enterprise groups.

Two, organize shareholding multinational companies each led by a large production enterprise, thus combining industry with trade, industry with agriculture, or industry with technology. Similar to multinational corporations in Europe and the United States, these multinational companies must have a diversified range of interests while concentrating on one industry. Even as they do a good job in industrial production, they should pursue the import/export business and related tertiary

industry aggressively. We must allow both models mentioned above to coexist instead of imposing artificial restrictions. But whichever model it follows, an enterprise group must make the transformation of its operating mechanism its top priority on which everything else depends, deepen internal enterprise reform, overhaul its operating mechanism, and fight for survival and development amid international competition.

3) Overhaul government functions, make China's foreign trade policy more open, and manage foreign trade in accordance with the law.

In a socialist market economy, the enterprise is a business legal person while the principal function of the government is to plan, coordinate, supervise, and provide services in order to create the external conditions conducive to fair competition between enterprises. It is not the government's job to interfere in the details of enterprise operations. It should also be emphasized that having the market fulfill its basic role in resource allocation does not amount to dispensing with macroeconomic regulation and control by the state. Nevertheless, the methods of government intervention should conform with international trade practices. Economic and legal tools should be used to guide enterprise conduct. Chambers of commerce and trade associations should be relied on to reconcile inter-enterprise interests. Laws, regulations, and policies should be made more open and foreign trade should be managed in accordance with the law.

4) Perfect the import system and integrate it into the international market as soon as possible.

To begin with, gradually lower China's import tariffs to the level that GATT requires of developing nations. At the same time, protect China's fledgling industries as necessary. We should see that at 22.5 percent, China's weighted average tariff rate currently exceeds the average in developing nations by 7.5 percentage points or so, with the exception of India and Pakistan. It is imperative therefore that China's import tariffs be cut by a wide margin.

At the same time, and without violating the principles of GATT, we must take care to give the necessary protection to certain vulnerable nascent industries such as electrical machinery, automobile, and the related parts industries.

Secondly, even as we phase out quantitative import restrictions over time, we must make the most of exceptions and safeguard provisions in GATT to secure more trade benefits. Gradually narrow the range of commodities under import permit management and introduce a general permit auction system.

(Writer's unit: Finance and Trade Institute, Chinese Academy of Social Sciences)

POPULATION

Article Views Population Issues, Problems

94CE0155A Beijing RENKOU YU JINGJI
[POPULATION AND ECONOMICS] in Chinese No 79,
25 Aug 93 pp 22-24

[Article by Tu Ping (3205 1627), Demographics Institute, Beijing University, and Peng Xizhe (1756 1585 0772), Demographics Institute, Fudan University: "Major Problems of Population Development"]

[Excerpts] [passages omitted] 2. Major Demographic Issues Facing China Today

As noted above, China has been immensely successful in balancing population growth with social development by lowering the birth rate and death rate. Nevertheless, the country still faces a string of problems and challenges on the demographic front due to social, economic, and cultural constraints and overwhelming demographic inertia.

1) Sustained Growth of Overall Population Size. The overall fertility rate of Chinese women has now approached the replacement level. However, because the population is so large to begin with and the fact that the huge number of women born in the baby boom of the 1960's are now in their childbearing years, China's overall population has been increasing fairly rapidly, with its birth rate and natural growth rate still a high 21 per thousand and 14 per thousand, respectively, in the late 1980's. There were 24 million births each year and the population increased by a net 16 million annually. Total population on the Chinese mainland broke the 1.15 billion point in mid-1991. On a per capita basis China currently has 1.3 mu of arable land, one-third of the average in the world, and 2,600 tons of fresh water, one-quarter of the world's average. Per capita grain output is 383 kilograms and the nation's gross grain output is just 22 percent that of the United States. If the current population growth rate continues, China's population will double by about 2040 to hit 2.3 billion. What we are facing is a dichotomy between a low birth rate and a huge volume of increase. If the population continues to grow at this rate, it will put enormous pressure on China's natural resources and ecological environment and create many difficulties for economic development. [Passage omitted]

2) Dramatic changes in demographic structure. The aging of the population is unavoidable as the birth rate and death rate drop. In 1990, there were 98 million elderly (60 years and older) Chinese, accounting for 9 percent or so of the total population. If China's overall birth rate drops to 2.1 by the year 2000 and stabilizes at 1.8 after 2010, and if life expectancy gradually rises from 69 in 1990 to 78 in 2050, then the elderly population would reach 128 million (10 percent of total population) by 2000, 280 million (19 percent) in 2050 [as published] and 412 million (27 percent) by 2050. Meanwhile, the percentage of the population between the ages of 0 and

14 will decline sharply after 2000, from 27 percent in 2000 to 19 percent in 2025 and 16 percent in 2500. The share of dependents in the population will follow an upward trend. In 1990, each member in the labor force supported 0.55 dependent. By 2000, he would support 0.58 person; by 2025, 0.59; and 2050, 0.77 person.

Since the future fertility rate may decline more rapidly than projected, the aging of China's population may accelerate, which would bring a string of serious social problems to a developing country like China, economically backward and lacking a comprehensive social security system. In China, the creation of a social security system (particularly a pension system) has been hampered by economic backwardness from the very beginning even as the presence of a huge elderly population vastly intensifies the sense of urgency about creating a pension system for the elderly and equally vastly complicates the task. Already reality rules out our adopting the approach in many developed nations, which is to fund a pension system through gradual accumulation. Moreover, there are enormous differences in the fertility and death rates from one region to the next in China, which means that the rate at which the population ages as well as the extent of aging also vary substantially on a regional basis. In Shanghai, people aged 65 and above already make up more than 10 percent of the population, whereas the comparable figure for some western provinces and regions is less than 4 percent. In large cities with extremely low birth rates, the aging of the population has probably reached proportions unknown anywhere else in the world at any point in history, putting the local governments, communities, and families under tremendous pressure. Therefore, while population aging is not yet a serious problem in China as a whole, it is a grim reality in some areas. Although the inflow of young people from high-fertility areas may slow down population aging on a macroeconomic level in those places which are the destinations of such young migrants, they cannot completely replace family members and relatives in taking care of the elderly on a daily basis and therefore solve the local population aging problem in a micro sense.

3) Sex imbalance worsening steadily In the wake of a declining birth rate, China, like many other developing nations and regions, faces a steadily worsening sex imbalance problem among its new-borns and the younger members of its population. In 1981, there were 108.5 live births of the male sex for every 100 female infants born alive. By 1989, the figure had risen to 113.8, 8.3 more than the norm (105.5). Based on these figures, about 880,000 fewer female infants were born in 1989 than we would have expected. A series of studies have shown that the under-reporting of female infants is a major explanation for the rising sex imbalance among new-borns in China today. Nevertheless, there is also a growing trend among women to opt for abortion after determining the sex of a fetus through ultrasound, so the use of ultrasound cannot be underestimated. In addition, there are also occasional reports of infants being abandoned or drowned in some places. All of that has already caused a host of social problems besides doing enormous harm to China's family planning image. (Tu Ping, 1993a and 1993b)

Table 3. Death Rates by Age and Life Expectancy at Birth in 1981 and 1990

Age	1981			1990		
	Male	Female	Ratio	Male	Female	
0	0.0361	0.0342	105.5	0.0313	0.0369	84.7
1	0.0160	0.0177	90.0	0.0098	0.0109	90.2
5	0.0065	0.0054	120.9	0.0042	0.0033	126.1
10	0.0039	0.0037	105.4	0.0032	0.0024	133.1
15	0.0054	0.0047	115.9	0.0052	0.0043	119.6
20	0.0071	0.0067	106.0	0.0074	0.0064	116.3
Life Expectancy	66.4	69.3	95.8	67.6	70.9	95.4

Source: Tu Ping (1993b)

4) Low educational standard. Even more worrisome is that female infant mortality rates have shown signs of heading upward again since 1980. While the death rate of girls between the ages of one and four has dropped, it is still higher than that of boys in the same age group. The death rate of girls five and older is lower than that for boys. To be sure, the data on death rates collected in the census are not reliable, so we cannot draw any firm conclusion from them alone. Still all the signs mentioned above should make the authorities concerned sit up and take notice.

In recent years China's drive to develop education and raise the scientific and educational standards of the entire population has been immensely successful. In 1982, 615, 6,779, and 17,892 of every 100,000 people in the nation had a college, senior high, or junior high education, respectively. Corresponding figures today are 1,422, 8,039, and 23,344, respectively. In 1982, 23 percent of the population were illiterate or semi-illiterate. By late 1990, the proportion had dropped to 16 percent. Be that as it may, there are still 180 million Chinese today who are illiterate or semi-illiterate, including 46.54 million between 15 and 39 years of age. Thus eliminating illiteracy among China's young people by the end of this century remains an uphill battle. The tidal wave of the market economy has dealt another blow to education, already suffering from under-funding and a severe brain drain problem. Institutions of higher education and research organizations have come under multiple pressures: insufficient funds, low pay, and the resultant brain drain, both external (qualified personnel going overseas) and internal (people leaving education for other high-paying sectors at home). If this situation continues, it will cause irreparable losses to the nation's long-term development. [passage omitted]

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'Mobile' Population in Beijing, Policy

94CE0156A Beijing RENKOU YU JINGJI
[POPULATION AND ECONOMICS] in Chinese No 79,
25 Aug 93 pp 35-39

[Article by Wang Ju (3769 5282), Shi Chongxin (0670 1504 2946), and Song Chunsheng (1345 2504 3932):
"Beijing's Mobile Population: Current Status, Policy"]

[Excerpts] [passage omitted]

1. Beijing's Mobile Population: Current Status and Characteristics

Mobile population in this context refers to the population who are engaged in a range of social and economic activities within the administrative jurisdiction of the municipality of Beijing but who do not have permanent registered residency in the city. It has two components: people from out of town who live in Beijing on a temporary basis and people who stay in Beijing briefly while in transit from one place to another (abbreviated hereafter as floating population).

According to statistics, Beijing had a mobile population of 210,000 in 1978, 640,000 in 1985, 1,310,000 in 1988, and 1.5 million in 1992. Of these 1.5 million people, a little over 1 million were temporary residents while 500,000 were in transit or were staying in Beijing briefly. Based on the study and analysis of the city's 1 million temporary residents, we can see that its mobile population has remained on a persistently high level. Its composition, however, has undergone significant changes and exhibits a number of new characteristics:

1) Workers and people engaged in commerce, services, and other economic activities make up the bulk of the mobile population. Statistics show that among the temporary residents, the number of people engaged in economic activities has been increasing steadily, reaching 770,000 by 1992, 77 percent of all temporary residents, 4 percentage points and 30,000 more than in 1988. The remaining 23 percent, or 230,000 people, comprised out-of-towners who were in Beijing on business, to sightsee, or to carry out other normal personal transactions.

2) Most temporary residents are males and people in their productive years. Among the temporary residents, 77 percent were male and 23 percent female. Its age breakdown is as follows: under 14 years old, 2.9 percent; between 15 and 25, 41.3 percent; between 26 and 35, 36.1 percent; between 36 and 59, 10.6 percent; and over 60, 9.1 percent. Thus people in their productive years between 15 and 59 years of age made up 88 percent of the temporary residents. We can thus see the mobile population is dominated by males and people in their productive years. A rising mobile population has enriched labor resources in Beijing and boosted labor supply.

3) The mobile population is of diverse origins, having come from all corners of the nation, including every province, municipality, and autonomous region. Three areas account for the bulk of the mobile population. One, the peripheral region. For instance, 31 percent of the mobile population came from Hebei. Two, impoverished areas with a surplus labor force. About 32.5 percent of the mobile population came from Henan, Anhui, and Sichuan. Three, areas with a developed commodity economy; 7.2 percent of the mobile population hailed from Zhejiang.

4) The mobile population is staying in Beijing longer and longer and is showing signs of striking root. According to statistics, 24 percent of the temporary residents stayed in Beijing for less than three months; 21 percent, between three and six months; 31 percent, between half a year and a year; 16 percent, between one year and three years; and 7 percent, above three years. The period of stay of the mobile population is getting progressively longer. Having stayed in Beijing several years, even a decade, some of the temporary residents have become in effect part of the permanent population without permanent registered residency. They buy or build houses in Beijing and acquire properties in hopes of settling down and striking root in the city. Neighborhoods with a heavy concentration of temporary residents are now sporting restaurants, clinics, day-care centers, and country markets that specially cater to them, forming self-contained multi-function mini-communities.

5) The trend among the mobile population is to enter Beijing in groups and concentrate in some neighborhoods. In recent years, increasingly more people are entering Beijing accompanied by friends, relatives, wives, children. People who hail from the same areas tend to cluster in the same neighborhoods in Beijing and likely are engaged in the same line of activity. The result is the emergence in close succession of a string of communities such as "Zhejiang village," "Henan village," "Anhui village," and "Xinjiang village" in the inner suburbs. Living up to its name "Zhejiang village," the Daihongmen neighborhood in Fengtai is now home to a temporary population of more than 10,000 people engaged in the processing, manufacturing, and sales of garments who originally came from Yueqing and Yongjia counties in Zhejiang. Over a thousand people from Henan live in the Erlizhuang neighborhood in

Dongsheng in Haiding, all of them involved in the business of gathering and buying scrap materials and junk. Seventy percent of the householders here live with their wives and children, while over 90 percent came here accompanied by fathers, sons, brothers, friends, relatives, and neighbors.

6) While the temporary population is concentrated in the inner suburbs, more and more newcomers to Beijing are settling down in the outlying suburban counties in recent years. Of the entire temporary population, 82 percent are distributed in the eight districts in the inner suburbs, including Hanyang, Haiding, Fengtai, and Shijingshan, which have the heaviest concentration of out-of-towners; between them are home to 60 percent of the city's entire temporary population. During the past decade, the temporary population in the four inner suburban districts increased 500 percent. About 18 percent of the temporary population live in the outer suburbs, a gain of 4 percentage points since 1986.

7) Most members of the mobile population find temporary lodging in construction sites, units, hotels, guest-houses, and rental housing. Statistics show that 28 percent of the temporary population live on construction sites, 26 percent in units, 16 percent in hotels and guest-houses, and another 16 percent in rental housing. Between them these several types of housing accommodate 86 percent of the temporary population.

2. Economic and Social Impact of Mobile Population on Capital

[passage omitted] 1) The entry of an army of construction workers into Beijing has lent direct support to urban construction in the capital. Construction teams made up of peasants that have sprung up like mushrooms have energized the ailing construction industry in the capital. Comprising low-wage, hardy, and efficient workers, these construction teams swept into the capital construction market and are becoming stronger and more competitive by the day. Construction teams from out of town have consistently made up 40 percent of construction workers in recent years. Because of their hard work, each year construction begins or resumes on 20 million square meters in capital construction projects and construction is completed on 10 million square meters of floor area, thereby ensuring the successful conclusion of a host of major construction projects.

2) The entry of large numbers of workers from out of town has eased the labor shortages in some trades and ameliorated the imbalances in the mix of labor. The economy of Beijing has developed rapidly since reform and the open policy got under way, with a steadily rising demand for labor. Meanwhile the industrial structure has changed, along with the way in which members of the public think about jobs. Consequently, jobs go begging in some trades and occupations such as construction, textile, chemical industry, environmental protection, and the coal industry, as well as a number of industries where work is filthy and hard or which do not

pay well. But the labor market has been replenished by the inflow of out-of-town workers. Besides the construction industry, 220,000 nonlocal workers are employed by factories and mines today. Out-of-town labor has solved the labor shortage in the above-mentioned industries.

3) The mobile population has helped revitalize the market in the capital. Tens of thousands of out-of-town merchants engaged in the buying and selling of vegetables, fruit, melons, poultry, eggs, fish, and pork have brought to the people of Beijing vegetables, poultry, pork, and eggs in large quantities. By amplifying the supply of commodities, they have played an irreplaceable role in diversifying the food basket of the population in the capital, at the same time enriching the flow of revenue into the coffers of the city.

4) It has made daily life easier for the masses by providing services and meeting other special household needs. Booths and stalls operated by nonlocals that serve breakfast, repair shoes, sew clothes, process woodwork, or do minor repairs dot the capital, filling gaps in the local service network and making life much easier for the public. Furthermore, as many as 10,000 nannies provide domestic help.

5) It has stimulated the development of the individual economy. According to information from the departments concerned, there are now over 10,000 out-of-town individual commercial households in Beijing involving more than 20,000 people. Of all the workers at stalls and booths operated by the city's 100,000 plus self-employed individuals today, more than 70 percent are nonlocals.

6) The mobile population has to some degree taken up agriculture, animal husbandry, sideline production, and fishery. As more and more peasants from Beijing's outskirts join township and town enterprises or leave town to go into business, an army of nonlocal peasants has filled the resultant void. Currently numbering a little over 20,000, some of them are hired by rural collectives and some do contract work for individuals. They grow field crops and vegetables, tend fish ponds and orchards, raise chickens, or are engaged in other areas of agricultural sideline production, contributing immensely to the completion of the nation's farming and animal husbandry tasks.

7) The enormous purchasing power of the mobile population has spurred commodity circulation. With its large size, the mobile population, particularly its consumption-oriented segment which visits the capital for sight-seeing and shopping purposes, constitutes a huge chunk of purchasing power and has been a driving force in the development of Beijing's economy. Statistically, the mobile population accounted for 33 percent of all commodity retail sales in Beijing in 1989. Not only has it increased commodity circulation in the market, but it has also enhanced the amount of revenue collected by the municipality.

There are two sides to everything. Even as it plays a major role in boosting economic development in the

capital, the influx of a million people into the capital has created a host of problems in such areas as economic order, urban management, and law and order, as demonstrated most strikingly in the following ways:

1) Rising crime has gravely jeopardized law and order in the capital. First of all, the mobile population is responsible for a steadily growing share of all crimes committed in the city every year. Not only has the mobile population exploded in size, but being highly diverse in composition, it also includes in its midst some criminals and fugitives on a law-breaking spree. According to statistics, of all criminals arrested in the city in 1990, 22.5 percent were from out of town. By 1991, the proportion had risen to 30 percent; by 1992, 37.6 percent. In neighborhoods heavily populated by the mobile population as well as the busy commercial district, as high as 70 to 80 percent of the criminals arrested are from out of town. Second, there has been a sharp jump in serious and vicious crimes committed by the mobile population. The number of serious crimes including explosions, poisonings, robberies, rapes, arson, murders, the illegal manufacturing and sale of guns and explosives, the counterfeiting and trafficking of renminbi, and kidnappings uncovered among the mobile population more than doubled between 1990 and 1991. For a small sum of money some criminals would not hesitate to rob and kill, with no regard for consequences. They are most vicious. Third, the mobile population is responsible for a stubbornly high proportion of all robberies and thefts. Of all robbers and thieves arrested in the city, 70 percent belong to the mobile population. Some of them specialize in robbing construction sites, stealing agricultural raw materials, cutting and stealing electrical wires and optical cables, or sabotaging power equipment and agricultural irrigation installations. Fourth, there has been an upsurge in crime committed by law-breakers working together. Over 60 percent of the nonlocal criminals arrested commit crimes in groups.

2) Illegal business activities are widespread, disrupting the normal economic order in the capital, as demonstrated most blatantly by the following. For starters, there are those who operate a business without a permit, evade paying taxes, or underpay taxes. According to a representative survey in the Fengtai district, about 46 percent of those hired as workers or engaged in commerce have no permit, either local or nonlocal. Tax cheating is extremely common among this group. Second, they manufacture and sell fake shoddy merchandise, severely damaging the consumers' interests. A substantial number of nonlocals engaged in commerce resort to every trick possible to make and sell bogus shoddy goods, swindling the customers and causing many serious injuries.

3) The steady expansion of the mobile population has exacerbated the inadequacies of urban infrastructural facilities. Take the Beijing railroad station, for instance. Built in accordance with the design specifications of the 1950's, it can handle at most 50,000 passengers a day but is coping with four to five times more traffic today. The

mobile population constitutes 70 percent or so of the total number of subway riders every day. Already the subway is running 40 percent over capacity, even 50 percent over capacity on holidays. Suppose each member of the mobile population takes 2.5 rides a day. City-wide, that translates into 3.5 million trips a day, putting the urban transportation system under enormous strains. The growth of the mobile population has also worsened water, electricity, and coal shortages as well as the scarcity of a number of resources already in short supply. In addition they have caused a string of problems in environmental protection and family planning. [passage omitted]

On the basis of our extensive study and following the growth pattern of the mobile population in the city in the last decade, with 1992 as the base year, we have divided that population into five categories: those who come to

Beijing for a variety of personal reasons, such as visiting relatives and friends, seeking medical treatment, and giving birth; those who are transferred to Beijing or come to Beijing to attend meetings, take refresher courses, or for other work-related reasons; those who are in Beijing as tourists; those who go to Beijing to find work, to engage in commerce, or to join the services sector; and the floating population. We have worked out the growth rate for each component of the mobile population in recent years and made some general projections regarding its overall size in the next few years. We are predicting that the mobile population will reach 1.8 million by 1995 and between 2.1 and 2.2 million by 2000. These are just predictions. As economic growth accelerates, they may well turn out to be underestimates. [passages omitted]

(Writers' work unit: Public Security Bureau, Beijing)

Article Criticizes 'Social Control' Model

94CM0092A Shanghai SHEHUI KEXUE [SOCIAL SCIENCES] in Chinese No 159, 15 Nov 93 pp 54-58

[Article by Tian Kejian (3944 0344 0313), Hebei College of Finance: "Achieving Modernization of Social Control—Viewing From an Anti-Corruption Standpoint the Shift From a Unidirectional Social Control to a Multidirectional Social Control"]

[Excerpts] A social survey by a certain municipal supervision bureau indicated that on average only 35 percent of the people are satisfied, or somewhat satisfied, with the state of the ongoing suppression of corruption and movement to establish honest government, while as many as over 60 percent indicated their dissatisfaction or a very low degree of satisfaction.

In the survey, more than half the people held "trading power for private benefits and misusing power for extortions" to be at the top of complaints, exceeding by far such items as graft and bribery, feasting and gift-giving, and dereliction of duties and malfeasance in office. This explains that when trying to tackle anti-corruption and ensuring honest government, it is above all most necessary to resolve the problem of controlling and restraining the behavior of civil servants, especially of those in important positions.

The declared purpose of the communist party is whole-hearted service to the people. After the workers had become masters of the state, an integration was achieved to the greatest extent of the various forms of powers with the masses. This was precondition and fundamental guarantee for the prevention of corruption and for putting a stop to corrupt practices. How is it then that the phenomenon of corruption is still so widespread today? We believe that to a great extent this is due to the pattern and methods of our social controls.

The system of social control in China is, on the whole, a model of centralized control in the form of a pyramid, small at the top and large at the base. Ranks and levels are clearly defined and marked out, and the organ of social control and control power is centralized at the top of the pyramid—the organ of supreme state power, which then exercises unified control over the entire society. Within the entire control system of the state, each subordinate unit has only one superior authority above it. Conversely, each higher authority has jurisdiction over a certain number of subordinate units. The relation between upper and lower ranks is also one of controller and controlled. The line of social control then naturally presents a unidirectional, vertical, from-top-to-bottom configuration. Through this vertical guidance and command relationship, control commands are relayed and put into effect rank by rank through administrative powers.

Although this kind of control pattern in China has the advantage of unity, standards, and centralization, it has, in the practice of its social control, actually formed a

model of unidirectional social control, unilaterally controlled by the administrative leadership. That means that the action of a single person at his work post (regularly manifested in the exercise of his power of office) is often only subject to the supervision and control of the higher ranking administrative leadership, and there is no other power in society authorized and capable of influencing his action. Because of the unified leadership and for the other reasons mentioned, the control powers of the judiciary, of the disciplinary control agencies, and of other departments specially charged with social control, are derived from the same higher authority of administrative control. In this way, their control operations and their effectiveness is either subject to powerful influences or they are actually becoming duplications or even appendages in the control exercised by the administrative leadership. This phenomenon becomes more serious the closer one gets down to the grassroots level.

Although the unidirectional social control has all along been of a certain effectiveness, the results have never been completely ideal. One may say, there has been a constant contest between the social controls and restraints on the one side and the undisciplined behavior and perversion of the law committed by certain civil servants on the other side. Many problems have repeatedly been regulated and have then again repeatedly reverted to cases of transgressions, which are now showing an abnormal, rising tendency. Why is that so? We believe the most important reasons are the following innate deficiencies of the unidirectional model in the system of social control.

First, the unidirectional social control force and social control pattern cannot possibly appropriately and thoroughly deal with each and every aspect of all affairs, and can, therefore, not avoid being deceived. On the one hand, the higher authority will always have under its direction a certain number of subordinate units, territories, and affairs; or will want to take on direct responsibilities for all kinds of administrative tasks; will also want to directly supervise and intervene, so as to effect in this pattern control and restraints over the work of many, many subordinate units. In an administration of this nature where "one is pitted against ten," it is very difficult to give attention to everything. If reports from some districts give indication of extensive unhealthy tendencies exhibited by county or "xiang" village cadres, we have to admit that this has to do with the attitude expressed in the saying "the mountains are high, and the emperor is far away," meaning that it has to do with an environment in which the forces of social control are very weak.

On the other hand, demands by the higher authorities on the subordinate units are brief and sweeping, and are therefore unavoidably breached in actual practice due to circumstances that really arise from the needs of the ongoing work. However, in a large number of cases where such breaches have occurred, the needs of the ongoing work were not the reasons, but rather corruption

and unhealthy tendencies using pretexts. In that event, one single higher-ranking administrative leadership will hardly be able to find all the needed abundant time to examine, analyze, and clarify all these cases. At the same time, due to the fact that it is characteristic for unidirectional control that the source of its driving force is only a single one and the control point too is only a single one, the subordinate unit can select a time, a place, and a matter when and where the higher authority is unable to pay attention, and this will allow the subordinate unit to "enact some tricks" in good time, also to prepare in advance a whole heap of high-sounding excuses if needed to stall off the higher authority.

Second, one unitary set of control norms cannot possibly be applied to the complex and changing social environment. In the whole range of affairs to be administered by one single higher authority there are always certain concrete work environments to which it is impossible to apply one single set of norms, that would inflexibly restrict the actions of all the people around. At the same time, the demands by higher authority on the lower-ranking units (they are actually some kind of social control norms) are frequently manifested in some documents or regulations, while, on the other hand, any kind of document or regulation cannot generally, in a very thorough way, go into all that is demanded by different actions engendered in the intricate division of labor, and can also not set clear and definite limits in the text. It is for this reason that the regulations which people get to see are always of a sweeping and broad nature. In the case of some affairs, once they are taken under administrative control they become inflexible as death, but once they are decontrolled they become unmanageably chaotic. This, one must say, is directly due to the contradiction between this type of unitary norms and the complexity and vicarious nature of the social environment.

Third, the person who is exercising control, standing all alone, cannot avoid being worn down by the practice of personal relationships. Because the source of the unidirectional control power is very unitary in nature, lawless elements have the possibility of playing all kinds of tricks to invalidate controls. It will be extremely difficult with

this kind of unidirectional social control to keep the situation free from the influences of complex human interrelationships.

Fourth, the unidirectional social control causes difficulties for the subordinate units in two respects. Since the subordinate units are subject to the control of only its own higher authority, while the actions of the higher authority are only controlled by its own higher authority, the subordinate unit is completely powerless in its relation to its higher authority; it is in the position of absolute obedience. In this way, even if some subordinate unit is averse to any kind of unhealthy tendencies, it has also to consider what the intentions of its superior authority are.

The above analyses will reveal that a major reason why it has been impossible during all this time to uproot certain unhealthy tendencies in society is the unidirectional pattern in the system of social control. Under certain conditions, social control, i.e. control by the broad masses over the few, will become much weakened, and will, conversely, end up in a situation of always allowing a small group of people committing encroachments upon the rights of the masses.

Unidirectional social control is an absurd, ineffectual, and unprofitable form of control. In the early years after liberation, when strict planned economy was being practiced, the deficiencies of the control in this form did not yet show up to any serious extent. This led some people to false assumptions. They started out from cherishing the memory of those days when the social atmosphere was very good, and this made them believe that the model of social control of those days will have eternal validity. Then they also deny that the present deficiencies of social control in certain areas are the result of shortcomings in the control pattern itself, merely regarding these deficiencies as due to the incompetence of certain personnel in actual charge of executing the said controls. This misconception is still up to today having an adverse influence on the reform and perfection of the social control pattern. It is necessary for us to soberly recognize that after 10-odd years of reform and opening up, the pattern of unidirectional control cannot any longer satisfy the demands of the present situation.

Economic Take-off Explained to Mainland Gathering

94CE00604 Chongqing GAIGE [REFORM] in Chinese
No 5, 20 Sep 93 pp 131-136

[Article by Li Kuo-ting (2621 0948 7844): "The Fruits of Taiwan's Economic Development and the Problems It Faces"]

[Text] *Editor's Note: Mr. Li Kuo-ting hails from Nanjing in Jiangsu Province. In 1930, he graduated from National Central University after which he went to Cambridge University in the United Kingdom to do research on physics. He served successively in Taiwan as Minister of Economics, Minister of Finance, and Minister Without Portfolio in the Executive Yuan. He is currently a political advisor to the President's Office, mostly concerned with academic financial and economic studies.*

Mr. Li Kuo-ting has a broad background in Taiwan's economy during the period when Taiwan changed from a predominantly agricultural society to a predominantly industrial one. He was instrumental in drawing up and putting into effect various policies that had a major effect on Taiwan's economy. During this period, Li Kuo-ting played a substantial role in what Taiwan terms going from a "tempering stage" to a "take-off stage."

Mr. Li Kuo-ting recently visited the mainland to take part in a World Bank-convened international panel discussion on China's macroeconomic management. The academic report that he prepared for the meeting had as its background experiences gained during the process of Taiwan's change from an agricultural society to a newly industrialized economy. It provided us with experiences from which we can draw lessons. He emphasized that "being generally able to adapt to requirements at the right times by adopting appropriate policies was the main reason for Taiwan's rapid and sustained development." This point should also be an extraordinarily important one for the orderly planning of China's economic reform and the formulation of policies. This issue of GAIGE publishes the full text of Mr. Li Kuo-ting's report as a service to readers.

The Taiwan territory is a natural resources-poor mini-economy, which gradually modernized by following free market economy principles. During the 1940's, it changed from a backward agricultural society to a newly industrializing economy, its economy developing more rapidly than that of other developing countries or territories, thereby creating a model for economic development.

Today, after several decades of involvement in planning Taiwan's economic development, I am very happy to have this opportunity to talk to you about Taiwan's economic development experiences and policies. I provide you this information for reference during the discussion period.

Achievements in Economic Development

During the early years of Taiwan's economic development, the economic situation was pretty much like that in most underdeveloped countries at that time that faced inadequate production, a shortage of money, pernicious inflation, a huge adverse balance of payments, and serious unemployment. However, from the early 1960's, thanks to having drawn up a body of new policies to encourage savings, encourage domestic and international investment, and to establish an export-oriented economy, Taiwan's economic system was able to meet international market competition. The economy changed rapidly, and during the past three decades substantial achievements have been made in economic development.

1. High Economic Growth and Stable Prices

Between 1960 and 1992, Taiwan's economic growth rate averaged 9 percent per year making it one of the world's small number of rapidly developing areas during that same period. Moreover, during the same period, consumer prices rose by an average 6.3 percent per year, slightly higher than in industrialized nations, but far lower than in developing countries. One of the small number of nations in the world having rapid economic growth, Taiwan was also able to maintain relatively stable prices at the same time.

National income also rose rapidly as the economy grew. In 1960, gross national income was \$154 per capita; by 1992, it was more than \$10,215 for twenty-fifth place in the world in income.

2. Rapid Expansion of International Trade

At the beginning of the switch to export-oriented development in 1960, exports amounted to \$160 million. By 1992, they had increased to \$81.5 billion. With the rapid increase in exports, import capabilities also increased tremendously during the same period going from \$290 million to \$72 billion. Imports and exports totaled \$153.5 billion for fourteenth place in the world. Beginning in 1970, the situation in which imports exceeded exports changed to exports exceeding imports. By 1986, China's favorable balance of trade had increased to 21.9 percent of GNP, but increase in the money supply had a counter effect on economic stability. This problem has been largely solved through the freeing of foreign exchange markets and the widening of capital flow.

3. High Savings and High Investment

In 1960, savings amounted to only 9.7 percent of GNP, and the investment rate was 16 percent. The shortfall between savings and investment was made up by American support at that time. After taking action to encourage saving and increase interest in investment, both savings and investment on the island increased. During the 1970's, the average savings rate reached 31.9 percent, and the investment rate rose to 30.5 percent. Taiwan become one of the few countries or territories in

the world enjoying both a high savings rate and a high investment rate at the same time. Therefore, since the mid-1960's, Taiwan has not had to rely on foreign loans to finance local investment. In recent years, the savings rate has surpassed the investment rate giving rise to marked imbalance in the overall economy.

4. Full Employment

Rapid industrial development created large numbers of employment opportunities, which soaked up the former underemployed or unemployed manpower in the agricultural sector, the unemployment rate declining greatly as a result. Since 1967, except for seven years when the unemployment rate stood at between 2 and 3 percent, in all other years, it has been less than 2 percent. Taiwan has attained full employment. In recent years, the unemployment rate has fallen to 1.5 percent. In addition, the large scale manpower demands of all-out public construction have produced a labor shortage.

5. Fairly Even Income Distribution

The widening of the gap between the rich and the poor that some economic development theories predicted in the course of Taiwan's economic development did not occur. Incomes of the highest 20 percent of families exceeded that of the lowest 20 percent of families less than five times in 1970. Income distribution gradually tended to even out. In 1980, the income distribution ratio was 4.17 times. This trend stopped later on and a gradual rise began. Although the figure rebounded to 5.18 in 1990, economic development continued to be oriented toward the goal of even income distribution.

Major Financial and Economic Policies in the Economic Development Process

Correct policy choices during Taiwan's economic development were important reasons for the aforesaid economic achievement. The most important decisions taken during the past 40 years may be generally capsulized as follows:

1. Land Reform

Land is the most important production resource in an agricultural economy and society, and it is also the problem that developing nations first face in the distribution of wealth. Between 1949 and 1953, Taiwan conducted land reform in three steps: the 37.5 percent rent reduction whereby cultivated land rent was reduced to no more than 37.5 percent of the year's harvest of major crops from the land; the relinquishment of public lands whereby public lands recovered from Japan following World War II were sold to peasants; and the land to the tiller policy whereby landlord holdings of more than 3 hectares had to be sold to the government, the government then selling it to tenant peasants who paid for it over a 10 year period.

Completion of farmland reform produced an enormous increase in the land that peasants farmed themselves. By

1960, peasant income increased threefold; agricultural production increased remarkably, and peasant purchasing power also increased greatly. As a result, the rural economy maintained steady growth, and agricultural surpluses were converted to investment in the development of industry, thereby laying a foundation for future industrialization.

2. Establishment of a Single Exchange Rate System

The multiple foreign exchange rate system adopted in the early years to make full use of limited foreign exchange obstructed exports. In 1958, a series of foreign exchange reforms were conducted that included the adoption of a single foreign exchange rate and devaluation of the New Taiwan dollar to its market level. On 1 July 1960, a single foreign exchange rate was instituted, the foreign exchange rate being fixed at NTS40 for \$1.00. For the next 25 years, this exchange rate was maintained with a 10 percent fluctuation up and down.

Realization of a single exchange rate provided favorable conditions for export-oriented development. It was Taiwan's first step toward entering world trade. This exchange rate was maintained until February 1973 when the New Taiwan Dollar was revalued for the first time by 5 percent.

3. Encouragement of Investment and Exports

During the early 1960's, export-oriented economic policies were adopted to maintain the development of industry. As an accompaniment to the improved non-government investment climate, incentive investment regulations were drawn up in September 1960. Rent and tax reductions and exemptions were used to encourage savings, investment, and exports. Things detrimental to capital formation or exports were eliminated, and acquisition of land for investment and the building of factories was simplified. After passage of regulations to encourage investment and associated reform measures, nongovernment investment and foreign investment gradually increased, and civilian savings rose markedly. Civilian entrepreneurs used their own limited resources to open international markets, and the value of exports also began to increase rapidly. In 1962, for the first time, exports of agricultural products became less than exports of industrial wares. The importance of the agricultural sector in the national economy gradually decreased with the growth of industry.

In looking back at this period, it is apparent that without the combination of foreign exchange reform, and encouragement of investment and savings, long-term, sustained growth of the economy could not have been sustained for the past 20 or 30 years. The new policies led to the development of export industries, which spurred the rapid economic growth of the 1960's. This was an important turning point period in the process of economic development.

Establishment of Processing Export Zones

During the early 1960's, Taiwan still had an adverse balance of trade, but manpower was ample, and most processing industries were gradually maturing, thereby creating a climate that attracted overseas Chinese and foreign traders to invest in Taiwan. In December 1966, factories began production in the export processing zone set up at the port of Kaohsiung. They engaged in processing and manufacturing, very quickly reaching saturation. So T'an-tzu in Central Taiwan and Nan-hsin in Kaohsiung were additionally designated for the establishment of two additional export processing zones.

The establishment of export processing zones was something new in the world at that time. Within the zones, administration was unified, procedures were simplified, imports of raw materials, spare parts, and mechanical equipment were exempted from duties, and no rebates had to be paid on exports. This attracted investment by both overseas Chinese and foreign businessmen. It also attracted much new technology and plant management methods from abroad. This served to spread the upgrading of industrial techniques throughout the island.

The policies adopted at that time were rooted in the urgent problems of surplus manpower and a shortage of foreign exchange, but it had not been envisioned that the subsequent benefits would extend to the present day. The three export processing zones had an area of less than 200 hectares, yet their achievements have been remarkable. Over the years, they have produced \$40 billion in exports. Labor intensive industries have also given way to technology-intensive industries, and they have created direct employment opportunities for approximately 65,000 people. Today more than 20 countries use this innovative system of export processing zones.

5. Population Policies and Manpower Resources Planning

Because natural resources were somewhat limited, manpower became the most important basis on which we could compete in economic development. We convened the first manpower conference back in 1964, hoping that education and training plans might meet manpower needs. A country needs large numbers of technical and vocational students to become industrialized. At that time, the ratio between senior middle school and senior technical schools was 60 to 4; today it is 3 to 7. Technically and vocationally educated people have become the main resources for economic development. Today, there is sufficient scientific and technical manpower at all levels, and the training system is fairly complete. Development of higher education is the focus of efforts. Science and engineering graduates account for 50 percent of all university graduates, and the number of post graduates working on a masters or doctors degree is also steadily rising.

Acceleration of economic development and increasing national income requires a population policy to slow

population growth. In 1960, the population increase rate was 3.6 percent, a very high percentage. In 1964, a 5 year family plan began to be instituted that extended from rural villages to cities. Results were excellent. In 1970, the net population growth rate fell to 2 percent for rather good control of population growth. In 1990, the growth rate fell further to 1.3 percent.

6. Development of Science and Technology

During the 1970's, two energy crises occurred. The international economic climate changed very greatly, and Taiwan's economic structure was facing a change. It was developing rapidly from labor-intensive industries to capital- and technology-intensive industries. Industry's demand for improved technology was urgent. Therefore, during the 1970's, the authorities laid plans to accelerate the development of science and technology in a change to greater development of applied technology to attain the goals of improving the industrial structure and product competitiveness.

In December 1976, the applied technology research and development group was founded as a work unit having special responsibilities. I was designated responsible for gathering people together to coordinate all sectors in moving ahead with the development of applied science and technology in a planned way. In 1978, the first Taiwan Science and Technology Conference was held. It presented ideas for all-out accelerated development of science and technology. In 1979, the "Scientific and Technical Development Plan" was drawn up for the selection of key scientific and technical projects and to support changes in the industrial structure.

During the 1980's, Taiwan's industrial structure entered the technology orientation development stage. During this stage, industry's technological capabilities gradually rose, and strong manufacturing ability was established in specific product fields. During the early 1980's, the emphasis was on electronics and information technology. Even today, the development of electronics, information, semi-conductor, and communications products holds an important position. The growth of these industries has been rapid, and they have become the biggest export industries. The extension of electronics industry technology will help increase the added value of other industrial products.

The Hsinchu Science and Industry Park established in 1980 as part of the effort to spur development of science and technology industries is a successful model. The park now has an annual output value of more than \$3.5 billion. Science and technology industries have become a new force powering the development of Taiwan's industry.

7. Economic Liberalization and Internationalization

Since the 1980's, major changes have occurred in both Taiwan's economy and the international economy. Since Taiwan continues to encourage exports, and since imports increase fairly slowly, the trade imbalance

problem has become larger and threatens financial stability. In the international economy, regional economic blocs are gradually taking shape throughout the world, and international industrial competition is intense. Industrial development must gradually become more internationalized.

In order to respond to this new development climate, during the mid-1980's freer and more international policies became the orientation for industrial development. Numerous actions were proposed, including the following: A great reduction of tariffs, and greater removal of restrictions on imports. By 1992, the average actual import duty rate fell to 5.1 percent. Promotion of a freer foreign exchange policy. In 1987, the "Foreign Exchange Control Regulations" were amended. Today, virtually all limitations on the import or export of foreign exchange have been eliminated. The price of foreign exchange reflects market supply and demand. In addition, greater financial freedom and the elimination of investment restrictions were promoted.

Elements Crucial to the Success of Economic Policies

In reviewing experiences in the development of Taiwan's economy, the general ability to adapt to requirements at opportune moments by adopting appropriate policies was the main reason for the rapid and sustained development of Taiwan's economy. Today, we are still able to maintain basic policies. The timing of our economic measures is not far off the mark. In the policy formulation realm, the key factors in the success of economic policies may be capsulized as follows:

1. The Market Economy and the Principle of Comparative Advantages

Although the authorities adopted various measures for the protection of industry in Taiwan's effort to develop its economy, for the most part they continued to create a climate for fair competition. The market pricing mechanism under a free market economy channeled the flow of resources in the direction of their most efficient use. Under the economic conditions at different stages, civilian enterprises applied manpower and technology resources, sought to develop products having comparative advantages, and raised the level of industrial development. At a time when civilian enterprises still did not understand new technology and new markets, government played a role, selecting appropriate administrative talent.

2. Civilian Enterprise Vitality.

Most of Taiwan's industry consists of medium or small enterprises. Ever since the export orientation of the 1960's, producers on the island have had to rely on their price advantage to compete successfully in international markets, and without having their markets on the island protected. Medium and small enterprises are characterized by high efficiency and ability to adapt. The upgrading of Taiwan industry, and the rapid advent of science and technology industries is a manifestation of

the vitality of civilian enterprises in seeking sources of technology and opportunities to develop markets. The vitality of civilian enterprises is the main force powering the "Taiwan economy."

3. Pragmatically Oriented Government Policies

The adoption of suitable development strategies in response to changes in the industrial structure was an important element in the successful development of Taiwan's economy. The various policies drawn up at various stages of development did not all turn out to be correct. Nevertheless, the policy makers always maintained a strong experimental spirit. Buoyed by a consensus about the direction to be pursued, policies that did not work were abandoned, and the majority of policies that proved effective were continued.

In the adoption of policies, two strategies that have been pursued from the early days to the present time merit particular explanation.

The first was "equal emphasis on economic growth and price stability." In order to avoid social and economic unrest resulting from price rises during economic development, from the very beginning "seeking growth while maintaining stability" became an important tactic in economic development. It was a goal pursued throughout economic decisionmaking.

The second was an orderly step-by-step industrial development policy that extended from the early period in which agriculture supported the development of industry to the spread of industrialization. It began in the 1950's with labor intensive nongovernment light industries that supplied internal needs in order to save foreign exchange, and it continued on into the 1960's when labor-intensive processing export industries were promoted. It was applied in the 1970's when there was a gradual shift to durable consumer goods and second generation industries, including various resources-intensive and technology-intensive heavy chemical industries. As a result, the second energy crisis in the 1980's spurred even more high technology industries. The training of human talent at the same time enabled their smooth development. This orderly, step-by-step modernization process during the past 30 or 40 years has created the "Taiwan experience" important development model.

Economic Problems Being Faced Today

Despite close attention to the formulation of new policies in keeping with advances during different stages in the development of the economy, new economic problems have risen under the impact of the international economy and the effect of political and economic factors in Taiwan itself. Let me explain:

1. Trade Imbalance.

Due to the widening of Taiwan's trade surplus during the 1980's, and no attendant widening of foreign exchange restraints, the currency supply increased tremendously. Surplus money created a real estate boom that set off a

money game mania that produced a bubble economy that jeopardized the stability of the entire economy. Although exports powered development of Taiwan's economy, imports were encouraged to deal with the increase in exports and help economic stability.

2. Imbalance Between Savings and Investment

The imbalance between savings and investment is a problem stemming from insufficient total demand. Savings have increased rapidly since the 1980's, but total fixed investment has increased slowly. The result has been excess savings and a year-by-year increase that peaked in 1986 when excess savings amounted to 21.4 percent of GNP. This showed ineffective use of a very large percentage of resources. During the past several years, the amount of surplus savings has shrunk as savings deposits have declined. The imbalance between savings and investment taken together with the trade imbalance means overall economic imbalance, which adversely affects long-term economic development. This also causes an outflow of capital from Taiwan, and it has also become the main reason why Taiwan is a main source of investment funds for southeast Asian countries.

3. Decline in Desire To Invest.

As an externally oriented economy, Taiwan must develop its economy in order to make its way in the world. The surge in domestic and foreign investment in the island that the drawing up of "Regulations to Encourage Investment" in 1960 produced had a very great effect in promoting economic take-off. During the past 30 years, however, the economy and the society have changed, and the investment climate has changed greatly. The outflow of money faced in recent years, the insufficient investment in production by people on the island, and the enormous reduction of overseas Chinese investment pose hidden dangers for long-term economic development. At the end of 1992, I personally proposed "moving ahead with the second stage improvement of the investment climate." By this was meant moving ahead with leasing and tax incentives, manpower planning and manpower use, and large scale investment plans, the development of high technology industries, and the drawing up of laws for further improvement of the investment climate and to stimulate interest in investing in order to spur the second transformation of the economic structure to bring about an upgrading of industry to the world standard.

4. Relative Inadequacy of Basic Public Facilities

Even though Taiwan has paid extremely close attention to the building of infrastructure, because of the too rapid

expansion of demand, public construction in recent years has not kept pace with economic development. This is particularly the case for transportation, environmental protection, and water resources facilities, which are inadequate. Not only does this impair a rise in the quality of people's lives, but it also obstructs modernization of the economy. Effective planning and building of complete basic public facilities is an urgent task in the future development of Taiwan's economy.

Conclusions

1. Experiences in the Development of Taiwan's Economy

The role of the agricultural sector, steady economic growth, the promotion of exports, and the orderly step-by-step development strategy that are a part of Taiwan's experience confirm some development rules. So long as policies meet economic development needs, they will help rapid economic development.

The importation of foreign capital and the rapid increase in exports under the mainland policy of opening to the outside world and reform have brought benefits in the form of economic growth. Because of the differences in systems, market scale, and resources on the two sides of the strait, the course of economic development will be different. The potential domestic market on the mainland hold tremendous benefits; it offers more development advantages than any other developing nation. The most important task today is to provide more employment to increase the earnings and purchasing power of every individual.

2. Economic and Trade Relations Between Both Sides of the Strait

The rapid growth of economic and trade relations between the two sides of the strait show that the economic conditions of both are strongly complementary. The future combination of markets technical capabilities, manpower resources, and investment for mutual benefit will be a major task for further development of economic and trade relations between the two sides.

3. Scientific and Technical Exchanges Between Both Sides of the Strait

Each side of the strait has its own technical capabilities, and scientific and technical exchanges are a natural trend. The mainland has very well developed basic science and technology, and since the 1970's, Taiwan has linked science and technology to the development of its economy. It has experience in applying science and technology to development, and much that merits the attention of the mainland. Both sides have a need to accelerate scientific and technical exchange.

Government Issues Mid-Year Economic Report

94CE0122A Hong Kong CHING CHI TAO PAO
[ECONOMIC REPORTER] in Chinese No 35, 6 Sep 93
p 2

[Unattributed article: "Hong Kong's Economy Continues To Look Good for Second Half of Year"]

[Text] The Hong Kong government recently issued the "1993 Mid-Year Economic Report." The report indicates that in the first half of the year, Hong Kong's economy continued its strong growth trend:

In terms of internal demand, consumer spending was vigorous, there was a sharp growth in retained consumer good imports, and retail sales also saw a large increase. Investment expenditures grew, and in comparison to the same period a year ago, for the first half of the year, retained capital goods imports rose by 7 percent.

In terms of foreign trade, in the first half of the year, the total value of exports continued to rise, increasing by 16 percent over the same period last year. Transit trade continued its rapid growth, and is still the major factor for the growth in overall exports. In comparison to the same period last year, it was up 26 percent in the first quarter and 19 percent in the second. Local product exports for the first quarter stayed the same, and dropped 7 percent in the second. As for imports, they grew by 19 percent in the first quarter and 12 percent in the second.

In terms of the stock market, on May 27, the Hangseng Index reached a new high of 7447 points, and in June entered into a period of consolidation, and that month the Hangseng dropped to 7099, though in comparison to last year the Index was up 28.8 percent.

In the second quarter of this year, the residential real estate market was brisk, and building prices saw a sharp rise, while rents went up. In the first half of the year, the tourism industry continued to do well.

In the first half of the year, the labor market was approximately stable, and in the second quarter, the seasonally adjusted unemployment rate was 2.2 percent, which represented a 0.1 percentage point drop in comparison to the same period a year ago.

In the first half of the year, the first class consumer goods price index increase, which last year dropped from 9.4 percent in the fourth quarter to 8.8 percent in the first quarter of this year, and 8.2 in the second quarter, meaning that for the first half of the year there was an increase of 8.5 percent in comparison to a similar period last year.

The various types of economic indicators mentioned above reflect the fact that there was a real increase in the total value of local production, which rose by 5.3 percent in the first quarter, and 5 percent in the second. Generally speaking, Hong Kong in the first half of the year continued to maintain excellent economic indicators.

The Hong Kong Government, according to the situation in the first half of the year and considering the objective factors for the second half of the year, has made several adjustments for the forecasting figures for Hong Kong's economy. The most important of these is in terms of the real growth rate in foreign trade, for which several adjustments have been made: Transit trade has been adjusted from 25 percent to 22 percent, local product exports have been adjusted from 1 to 1.5 percent, exports from 18.4 percent to 15.6 percent, and imports from 18.7 percent to 16 percent. Though for the second half of the year the growth rate for foreign trade has slowed somewhat, because private consumer spending continues to rise, the tourist industry continues to be brisk, the labor market is stable, while the unemployment rate has been maintained at a low level, hence the Hong Kong Government will maintain its original forecast of a 5.5 percent real annual growth rate of gross output value. As for the first class consumer price index, based on the slowing trend for the first half of the year, the original forecast of 9.5 percent has been lowered by a half percentage point to 9 percent.

Two months have already passed since the first half of the year. If we can say that for the first half of the year, under conditions in which the Sino-British dispute over the political system was not resolved, China's economy developed rapidly, and Western economies remained stagnant, Hong Kong's economy still had a comparatively good showing, then what can we say about how the economy will develop in the second half of the year? In particular, after July, when China adopted 15 measures to strengthen macroeconomic regulation, what effect has this had on, and how has it changed Hong Kong's economy? Will Hong Kong be able to maintain the growth posture of the first half of the year, and continue to look good? Can it realize a 5.5 percent annual growth rate?

It should be said that the Hong Kong government, when it forecasts the economic situation for the second half of the year, has already "considered that economic recovery in the major industrial countries is expected to be slow, and in particular, while China recently announced it would be using a policy of retrenchment to attack overheating of the economy." Nevertheless, Hong Kong Government officials believe that based on their observations, China will not take measures that result in a thorough and abrupt retrenchment, and for this reason will not create a serious blow to the economy of Hong Kong, rather certain aspects of China's trade with and investment in Hong Kong could be affected after a certain period. This is how things indeed stand. For example, for businesses engaged in importing to and exporting from China, for businesses conducting processing of materials [supplied by foreign clients] or stressing domestic sales, or for businesses investing urgently in China or for other businesses, the circumstances are different, and the effect produced will be different. The major point, however, is that with China strengthening macroeconomic regulation, not only will

there be no effect on Hong Kong's economy or little effect, but on the contrary, looking at the situation from a long-term point of view, because it is advantageous for China, in the end it must be beneficial for Hong Kong. Recently, Jiang Zemin and Zhu Rongji separately stated that the two months constituting the initial stage of China's strengthening of macroeconomic control have been successful. This primarily reflects the following: the phenomenon of illegal diversion of funds [chaijie] has basically been checked, the chaos in the collection of funds is in the early stage of coming under control; in agriculture, the summer grain crop purchasing was basically free of the issuing of "blank chits," and bank reserves are rising, while the exchange rate is tending towards stability, prices for the means of production have dropped, and the economy continues to develop in a good direction. To be sure, rectifying the financial order and enforcement of financial discipline will not prove to be effective overnight, and require getting at the root of the problem, merely relieving the symptoms will result in the problems returning. However, this time, as China strengthens macro regulation, the goal is the deepening of reform, the transformation of mechanisms,

the improvement of structures, and the increasing of efficiency. The approach is to use economic measures, legal methods, and the required administrative measures suited to market economic patterns. These goals and methods are basically beneficial to China's reform and opening and development, and hence are naturally beneficial to Hong Kong businesses conducting investment and trade on the mainland. Blocking the abnormal, and opening to the proper, opposing corruption, advocating honest government, and similar approaches are also the optimum guarantee for appropriate investment and economic trade to gain profit. Now that China is strengthening macro regulation, in order for China to deepen reform and expand opening, and in order for China's economy to sustainably, stably, and harmoniously develop, when looking ahead to the performance of Hong Kong's economy in the second half of the year, we should not worry about China's strengthening of macro regulation, but on the contrary, we should look for China to have even better reform, opening and development and have reason to regard as favorable Hong Kong's economy in the second half of the year.

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